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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1980

ST. MARTIN EVANGELICAL LUTHERAN CHURCH and NORTHWESTERN LUTHERAN ACADEMY,

Petitioners,

v.

THE STATE OF SOUTH DAKOTA

PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF SOUTH DAKOTA

Edward Thomas Schilling
757 North Broadway, Suite 500
Milwaukee, Wisconsin 53202
414/276-1122
and
Ernst J. von Briesen
757 North Broadway, Suite 500
Milwaukee, Wisconsin 53202
Counsel for Petitioners

of counsel:
VON BRIESEN & REDMOND, S.C.
757 North Broadway, Suite 500
Milwaukee, Wisconsin 53202

HAMMERSMITH-BREITHAUPT PRINTING CORP., MILWAUKEE, WIS. 53212

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Edward Thomas Schilling, on behalf of St. Martin Evangelical Lutheran Church and Northwestern Lutheran Academy, petitions for a Writ of Certiorari to review the judgment of the Supreme Court of the State of South Dakota entered in this case on March 26, 1980 and the oral order denying Petition for Rehearing entered on May 2, 1980.

QUESTIONS PRESENTED

I. Whether application of the Federal Unemployment Tax Act as adopted by the State of South Dakota, to church elementary and secondary schools violates the Establishment and Free Exercise

Clauses of the First Amendment to the Constitution of the United States?

A. Does administration of the Federal Unemployment Tax Act involve impermissible inquiry by the State into religious law and polity?

B. Does administration of the Federal Unemployment Tax Act by the State involve comprehensive and continued surveillance of churches?

II. Whether there is a significant risk that a First Amendment right will be infringed so that there must be a clear expression of affirmative intent by Congress to include church elementary and secondary schools within the Federal Unemployment Tax Act, as adopted by the State of South Dakota?

III. Whether church elementary and secondary schools are exempt from coverage under the Federal Unemployment Tax Act, as adopted by the State of South Dakota.

PARTIES TO THE PROCEEDING AND STATEMENT UNDER RULE 28.4(b)

All parties to the proceedings from the Supreme Court of the State of South Dakota, from whose judgment review is sought, are included in the caption of the case before this Court. However, the constitutionality of an Act of Congress, the Federal Unemployment Tax Act, 26 U.S.C. §3301 et seq., as applied to church elementary and secondary schools is drawn into question in this matter and neither the United States nor any department, office, agency, officer or employee thereof is a party; therefore, 28 U.S.C. §2403(a) may be applicable.

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OPINIONS BELOW

The opinion of the South Dakota Supreme Court, reported at 290 N.W.2d 845 (S.D. 1980), appears in the appendix (Appendix A, pp. A1-A24). The opinion of the Circuit Court, Sixth Judicial Circuit of South Dakota, not reported, appears in the appendix (Appendix B, pp. A25-A34). The opinion of the hearing officer for the South Dakota Department of Labor Unemployment Insurance Division, not reported, also appears in the appendix (Appendix C, pp. A35-A45).

JURISDICTION

The judgment of the Supreme Court of South Dakota was entered on March 26, 1980. A timely petition for rehearing was denied by oral order on May 2, 1980. This Court's jurisdiction is invoked under 28 U.S.C. §1257(3) (1970).

CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED

The First Amendment to the Constitution of the United States, made applicable to the states by the Fourteenth Amendment provides in pertinent part:

> Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof.

The relevant provisions of 26 U.S.C. §3309(a) (1970), as it existed prior to the Unemployment Compensation Amendment Act of 1976, Pub.L.No. 94-566, §115, 90 Stat. 2670, which in effect, repealed Sec. 3309(a)(3) (1970), are as follows:

> (1) in the employ of (A) a church or convention or association of churches, or (B) an organiza-

tion which is operated primarily for religious purposes and which is operated, supervised, controlled or principally supported by a church or convention or association of churches.

(2) by a duly ordained, commissioned, or licensed minister of a church in the exercise of his ministry or by a member of a religious order in the exercise of duties required by such order.

(3) in the employ of a school which is not an institution of higher education.

The relevant provisions of the South Dakota statutes, S.D. Compiled Laws Ann. §61-1-10.4, adopted to conform to federal law, as it existed prior to January 1, 1978 (before repeal of S.D. Compiled Laws Ann. §61-1-10.4(3) are as follows:

(1) In the employ of

(a) a church or convention or association of churches, or

(b) an organization which is operated primarily for religious purposes and which is operated, supervised, controlled or principally supported by a church or convention or association of churches; or

(2) By a duly ordained, commissioned or licensed minister of a church in the exercise of his ministry or by a member of a religious order in the exercise of duties required by such order; or

(3) In the employ of a school other than a state school which is not an institution of higher education; or

. . . .

STATEMENT OF THE CASE

A. The Federal Questions Were Raised in the Proceedings Below

All of the federal questions sought to be reviewed before the United States Supreme Court, including the violation of the establishment and free exercise clauses of the First Amendment to the Constitution of the United States, were first raised in oral argument and the briefs filed in the Administrative hearing before the South Dakota Department of Labor-Unemployment Insurance Division. The decision by the Appeals Referee found that the U.S. Department of Labor directed states to extend unemployment insurance coverage to employees of church elementary and secondary schools, (Appendix C, p. A40) and that in view of the directive from the U.S. Department of Labor the referee could not accept the constitutional argument. (Appendix C, p. A45).

The Notice of Appeal by Northwestern Lutheran Academy and St. Martin Evangelical Lutheran Church to the Circuit Court of South Dakota and the Assignment of Errors filed therein both included the constitutional issues. The Decision by the Circuit Judge (Appendix B, pp. A30-A33) found the churches exempt from the unemployment compensation law, and because of this finding that court felt it was unnecessary to address the constitutional question. (Appendix B, p. A33).

The Assignments of Error in the appeal to the Supreme Court of South Dakota by the State of South Dakota included the charge that the circuit court erred in failing to reach the constitutional issue. The decision by the Supreme Court of South Dakota (Appendix A, pp. A1-A24) covered all of the federal questions involved, including the constitutional question.

B. Brief Statement of Facts and the Proceedings Below

Northwestern Lutheran Academy is a four year preparatory school for entrance at Northwestern College or Dr. Martin Luther College in preparation for the preaching or teaching ministry (Appendix C, p. A39).

St. Martin Evangelical Lutheran Church is a Lutheran church that operates a parochial elementary school (Appendix C, p. A38).

Northwestern Lutheran Academy, which is not separately incorporated, but is owned and operated by the Wisconsin Evangelical Lutheran Synod, and St. Martin Evangelical Lutheran Church, which is separately incorporated as a church under South Dakota law, are both members of and part of the Wisconsin Evangelical Lutheran Synod (Appendix C, p. A36).

The Wisconsin Evangelical Lutheran Synod currently has 1105 member congregations in 47 states and three provinces of Canada (Appendix C, p. A36). Many of its member churches maintain elementary Christian day schools like the school maintained by St. Martin Evangelical Lutheran Church. In addition to area Lutheran high schools, which are maintained by associations of member churches, the Synod maintains four academies, of which Northwestern Lutheran Acadamy is one, two colleges and one theological seminary (Appendix C, p. A36).

Futher appropriate facts are in the Findings of Facts found in the Administrative Decision by the hearing officer for the South Dakota Department of Labor (Appendix C, pp. A36-A40).

Prior to January 1, 1978, the Federal Unemployment Tax Act (26 U.S.C. §3301 et seq., permitted states to

exempt certain services from taxation, which were codified in South Dakota in S.D. Compiled Laws Ann. §61-1-10.4. These exemptions provided that employment covered did not include services performed:

> (1) In the employ of (a) a church or convention or association of churches, or (b) an organization which is operated primarily for religious purposes and which is operated, supervised, controlled, or principally supported by a church or convention or association of churches;
>
> (2) By a duly ordained, commissioned or licensed minister of a church in the exercise of his ministry or by a member of a religious order in the exercise of duties required by such order;
>
> (3) In the employ of a school which is not an institution of higher education . . . .

In 1976, the Federal Unemployment Tax Act was amended by Pub.L.No. 94-566, §15, 94 Stat. 2670, "The Unemployment Compensation Amendment Act of 1976," and as required by Congress, the South Dakota legislature, among other things, in effect repealed subsection (3) of S.D. Compiled Laws Ann. §61-1-10.4.

Thereafter, in December of 1976 and February of 1977, the U.S. Department of Labor issued two interpretive memoranda to state labor agencies explaining the repeal of 26 U.S.C. §3309(b)(3). These memoranda stated that the exemptions of 26 U.S.C. §3309(b)(1) and (2) would continue to apply to church schools. (Appendix E, pp. A62-A63 and Appendix F, pp. A64-A67).

Then, in April 1978, the U.S. Secretary of Labor announced in a letter to the Most Reverend Thomas C. Kelly, General Secretary of the U.S. Catholic Conference,

that the repeal by Congress of the primary and secondary school exclusions intended to result in unemployment compensation coverage of church related schools. Memoranda of this interpretation by the U.S. Secretary of Labor were given to the States and thereafter the South Dakota Department of Labor issued a determination that Northwestern Lutheran Academy and the school which is a part of St. Martin Evangelical Lutheran Church were subject to coverage under the unemployment insurance laws.

This determination was appealed by the church and the Wisconsin Evangelical Lutheran Synod to an Appeals Referee of the South Dakota Department of Labor. The Administrative Decision (Appendix C, p. A44) held that Northwestern Lutheran Academy and St. Martin Evangelical Lutheran Church were not exempt from the unemployment compensation law, that male teachers were ministers and therefore, exempt from coverage, but that female teachers were not ministers nor members of a religious order and therefore subject to coverage. The appeals referee further stated that because of the directive from the U.S. Department of Labor mandating coverage of church schools the Church's constitutional argument could not be accepted.

Northwestern Lutheran Academy and St. Martin's Evangelical Lutheran Church appealed to the Circuit Court of the Sixth Judicial District, Hughes County, South Dakota. That court concluded in its Memorandum Decision dated March 19, 1979, that the operation of these church schools was primarily for a religious purpose and that they were exempt under the Act from coverage. Therefore, the court did not find it necessary to address the constitutional issues raised nor whether female teaching ministers were exempt from coverage. (Appendix B, p. A33).

The State of South Dakota appealed from the judgment of the circuit court to the Supreme Court of South Dakota which reversed the circuit court (Appendix A, pp. A1-A24). The South Dakota Supreme Court held that Congress "apparently" intended to include elementary and secondary church schools within the unemployment compensation law when it repealed the elementary and secondary school exemption in 26 U.S.C. §3309(b)(3); that coverage of elementary and secondary church schools does not infringe on the freedom of religion guaranteed by the First Amendment to the Constitution; that coverage would not foster excessive entanglement even though "inclusion . . . will necessarily call for increased involvement between the state and the schools . . ."; and, that female teachers are not exempt from coverage as members of religious orders or as ministers because "they are allowed to perform only those functions normally associated with basic education."

REASONS FOR GRANTING THE PETITION

A. THE STATE OF SOUTH DAKOTA HAS DECIDED A FEDERAL QUESTION IN CONFLICT WITH THE DECISION OF ANOTHER STATE COURT OF LAST RESORT.

The Supreme Court of the State of North Dakota on June 20, 1980, held that a church operated school was exempt from unemployment compensation coverage as a church under 26 U.S.C. §3309(b)(1) and the North Dakota "mirror image" of the federal statute. The court further held that any attempt to include parochial schools under the Act would raise serious questions as to excessive governmental entanglement with religion. *Grace Lutheran Church v. North Dakota Employment Security*

Bureau and North Dakota Unemployment Compensation Division, — N.W.2d —, Civil Case No. 9419 (not yet reported but included in Appendix D, pp. A46-A61). The decision by the Supreme Court of North Dakota is in direct conflict with the decision of the Supreme Court of South Dakota for which the petition for a writ of certiorari is being sought.

The Court of Appeals of the State of Oregon in *Employment Division v. Archdiosese of Portland,* 42 Or. App. 421, 600 P.2d 926 (1979) held that Catholic parochial schools were exempt from the unemployment compensation tax. This decision is not by the highest court of the State of Oregon because the state failed to appeal the decision.

The South Dakota Supreme Court decision conflicts with every other court that has decided the merits of the issue of coverage of church operated schools under the unemployment compensation law. Comment, *Bringing Christian Schools Within The Scope of the Unemployment Compensation Laws: Statutory and Free Exercise Issues,* 25 Vill.L.Rev. 69 (1979-80). This conflict is more fully set forth in subsection C of this petition.

B. THE ISSUE OF COVERAGE OF CHURCH SCHOOLS UNDER THE FEDERAL UNEMPLOYMENT TAX ACT INVOLVES SUBSTANTIAL FEDERAL QUESTIONS.

1. The Federal Questions Involved Affect Every State Unemployment Fund and Every Religious Denomination.

The Federal Unemployment Tax Act (codified at 26 U.S.C. §3301-3311) is a comprehensive federal-state em-

ployment compensation system. Under this, and related tax laws, credits against the federal tax are given to employers and grants are given to states to administer their programs if the Secretary of Labor certifies that the state's law conforms to the federal law and that the state complies with these laws during an annual certification period. (See 26 U.S.C. §3302(a) and (b); 29 U.S.C. §49d; 42 U.S.C. §501; 26 U.S.C. §3304(c)).

The controversy between churches that operate schools and the states began when the U.S. Department of Labor reversed itself (See Appendix E, pp. A62-A63 and Appendix F, pp. A64-A67) and, directed the states to include employees of church schools within unemployment compensation law or lose their certification. (Unemployment Insurance Program Letter No. 39-78, May 30, 1978, State Exhibit 1).

Six states — Nevada, Alabama, Michigan, Tennessee, Texas and Washington — refused to extend unemployment compensation coverage to parochial schools and in 1979 the U.S. Secretary of Labor formally notified them of their non-compliance.

An administrative proceeding was had by two of these states, Alabama and Nevada, which is now on appeal in the United States Court of Appeals for the Fifth Circuit. *United States Department of Labor v. Alabama Department of Industrial Relations and Nevada Employment Security Department,* 44 Fed. Reg. 64, 378 (November 6, 1979), appeal filed, No. 79-4032 (5th Cir. 1979). Participating in this case are the Alabama Association of Christian Schools, Roman Catholic Dioceses of Nashville and Memphis, United States Catholic Conference, General Conference of Seventh-day Adventists, and Lutheran Church-Missouri Synod.

2. Coverage of Church Schools Under Unemployment Compensation Law Involves Excessive Entanglement Between Church and State.

a. The State Has Become Excessively Entangled In Its Inquiry Into Church Affairs.

If church schools are covered under unemployment compensation statutes church officials would be required to file reports with state agencies; keep work records which would be open at any time to state officials; answer subpoenas for information as the State of South Dakota has done here; respond to claims for benefits; and, participate in hearings on eligibility for benefits.

In *Surinach v. Pesquera de Busquets,* 604 F.2d 73 (1st Cir. 1979) the court held similar regulatory involvement unconstitutional under statutes investigating the rising costs of education, including that of church elementary and secondary schools. The court recognized that the government's

> ongoing powers necessary to ensure compliance with its orders and regulations, from compelling the keeping of records and the providing of testimony to the continuing inspection of papers and physical facilities . . . [have] the 'self-perpetuating and self-expanding propensities' which have alerted courts to an increased danger of an unconstitutional degree of entanglement. (*Id.* at p. 78).

In *McCormick v. Hirsch,* 460 F.Supp. 1337 (M.D. Pa. 1978) the court summarized the various factors in the school aid cases that led to a finding of excessive entanglement:

> The Court in applying this test has shown a particular concern and has sought to avoid active involvement of the sovereign in religious activities,

> the risks inherent in programs that bring about an administrative relationship between public bodies and church-sponsored schools, governmental evaluation and standards with respect to religious practices, any kind of day-to-day relationship between church and state, extensive investigation into church operations or finances, any sustained or detailed administrative relationship for enforcement of statutory or administrative standards, inherent difficulties in the combination of religious discipline and the possibility of disagreement between teacher and religious authorities over the meaning of statutory restrictions, and the entanglement of government in difficult classifications or what is or is not religious. (460 F. Supp. at 1352 (footnotes omitted)).

The above summary accurately reflects the constitutional problems inherent in bringing parochial schools within unemployment compensation law.

b. The State Has Become Excessively Entangled In Its Inquiry Into Religious Law And Polity.

The extent of inquiry into religious law and polity is clearly demonstrated by the South Dakota Supreme Court's holding that:

> Respondents argue that such [female] teachers cannot be denied exempt status, because the Synod dogmatically considers its female teachers to be part of its Christian ministry. The fact, however, is that female teachers in respondents' schools are not permitted to perform any sacerdotal duties or to vote on Synod matters; rather, they are allowed to perform only those functions normally associated with basic education. Appendix A, p. A16.

The South Dakota Supreme Court has taken upon itself the role of defining what constitutes the public ministry of the Wisconsin Evangelical Lutheran Synod.

Another example of the state's intrusion into religious law and polity involves the termination of a teacher. Under Unemployment Compensation Tax Law, an employee who is discharged for misconduct or terminates his employment without cause may be denied benefits. Thus, it becomes important to determine the reasons for termination. If a Synod teacher were discharged for teaching contrary to Synod doctrine and belief, or voluntarily terminated employment because of differences in doctrinal belief, the teacher could request a hearing to determine if unemployment compensation benefits were due. This hearing would involve doctrinal questions of belief and the hearing examiner would have to rule on these issues. The scope of the inquiry would involve the validity of the reason for the termination which of necessity would involve church doctrine.

Catholic Bishop of Chicago v. National Labor Relations Board, 559 F.2d 1112 (7th Cir. 1977), *aff'd on other grounds,* 440 U.S. 490 (1979) clearly demonstrates the constitutional problems that would be involved in that kind of inquiry by the State.

c. Administration of Unemployment Compensation Law Involves Excessive Surveillance of Churches by the State.

U.S. Department of Labor Unemployment Insurance Program Letter No. 39-78 dated May 30, 1978 (St. Exh. 1) provides that if an employee performs both non-exempt and exempt services during a single employment period, as in the case of services performed for a church-related school and a church, and the exempt service amounts to more than 50%, then all of the service of that employee would be exempt.

The potential for excessive entanglement in making these decisions is manifest. That religious teaching permeates the curriculum of private religious schools has been clearly acknowledged by the Supreme Court of the United States. *Lemon v. Kurtzman,* 403 U.S. 602 (1971).

In this case, as in *Lemon,* the inquiry necessarily involved in policing the application of the exemption "puts a public investigator into every classroom and entails a pervasive monitoring of these church agencies by the secular authorities." *Lemon,* 403 U.S. at 627. Yet without such monitoring, there would be no way of making the determinations required by the Secretary's interpretation of 26 U.S.C. §3309. As stated in *Catholic Bishop* "[i]t is not only the conclusions that may be reached . . . which may impinge on rights guaranteed by Religion Clauses, but the very process of inquiry leading to findings and conclusions." 440 U.S. 490 (1979).

The church schools in this case argue that all of their courses of study are designed to advance their religious principles. Thus, in order to enforce the tax, it will be necessary for the state to determine as to each employee whether his or her activities are "purely religious" more than one-half of the time. That controversies will arise, for example, as to whether in a world history class the teacher spends more than one-half of any given session teaching purely "religious" or purely "secular" history can hardly be subject to doubt.

And, a janitor and church secretary would perform services for both the church and the school which is part of the church. A female teacher might, as part of her duties, teach Sunday School in the church basement, or the school basement, play the organ for church services and be responsible for the church choir. There might

be "church" functions in the school and "school" functions in the church. Thus, the state is required to make the determination whether, during any given pay period, an employee has spent less than one-half of his time on purely religious activities. If so, that employee is subject to unemployment compensation law.

3. The Decision by the Supreme Court of South Dakota Is Contrary To The Decision By This Court in National Labor Relations Board v. Catholic Bishop of Chicago, 440 U.S. 490 (1979), Because There Was No Clear Expression By Congress of An Affirmative Intent to Bring Church Schools Within the Unemployment Compensation Law.

This Court held in *National Labor Relations Board v. Catholic Bishop of Chicago,* 440 U.S. 490 (1979), that where there was a "significant risk" that the First Amendment might be infringed by some sort of entanglement between the church and State that there must be an "affirmative intention of the Congress clearly expressed" before the Court would construe coverage of parochial school teachers under the National Labor Relations Act.

That there is a significant risk of infringement of First Amendment rights, if not a clear demonstration of excessive entanglement, seems obvious when one considers the information required of churches by the state that heretofore has never been required, the inquiry into religious law and polity, and the surveillance necessary to police the law's provisions.

The South Dakota Supreme Court based its decision on the "apparent" intent of Congress and the political

expediency of that state's interest in conforming with the mandate by the U.S. Secretary of Labor.

The South Dakota Supreme Court ignored the fact that Congress did not express a clear and affirmative intent to bring parochial schools within coverage of the unemployment compensation law; further, the South Dakota Supreme Court ignored Congressional history of the amendment to the Federal Unemployment Tax Act, the contemporaneous interpretation by the U.S. Department of Labor, the consistent interpretation by the Internal Revenue Service of the broad meaning of "church," and the consistent rulings by the United States Supreme Court that church operated schools are primarily religious and are an integral part of the church.

4. The Decision by the South Dakota Supreme Court is Incongruous With Decisions by the U.S. Supreme Court Concerning Church Operated Schools.

The United States Supreme Court has consistently held that parochial, elementary and secondary schools may not receive state aids because they are an integral part of the church and serve a primarily religious purpose.

The decision by the South Dakota Supreme Court creates the incongruous result that church operated schools are not an integral part of the church nor primarily religious for the purpose of paying unemployment taxes, but constitutionally an integral part of the church so that they cannot receive parochial aid.

C. THE WIDESPREAD LITIGATION OF THE FEDERAL QUESTONS INVOLVED SHOULD BE SETTLED BY THE SUPREME COURT.

The national effect of coverage of church elementary and secondary schools is reflected in the widespread litigation of the issue.

In addition to the conformity proceedings involving Nevada, Alabama, Michigan, Tennessee, Texas and Washington referred to at Part B, 1 hereof, there is other litigation in federal and state courts involving coverage of church schools under unemployment compensation laws.

The United States District Court for the Central District of California granted a temporary injunction to two church groups enjoining the State of California from collecting unemployment taxes. *Grace Bretheren Church v. State of California,* Case No. CV 79-93 MRP (September 21, 1979) ; *Lutheran Church-Missouri Synod v. the State of California Employment Development Department,* Case No. CV 79-162 MRP (September 21, 1979). The court based its injunction upon separate findings that (1) the church operated schools come within the 26 U.S.C. §3309(b)(1)(A) "church" exemption; and that (2) the imposition and collection of the tax would be unconstitutional due to excessive entanglement between the Church and State.

Numerous cases have been initiated by parochial schools in the state courts and where the substantive issues were reached all have decided in favor of the schools at the trial level on the basis that the schools were exempt under the "church" exclusion or that there would be excessive entanglement. See *Grace Brethren Church v. California,* Nos. CV 79-93 MRP, CV 79-162

MRP, slip op. at 7-9 (C.D. Cal. Sept. 21, 1979); *Trinity Evangelical Lutheran Church v. Department of Indus. Relations,* No. CV 78-500325 (Cir. Ct. Mobile County, Ala., Jan. 27, 1979); *Roman Catholic Church v. Louisiana,* No. 219, 660 (19th Jud. Dist. Ct., East Baton Rouge Parish, La., Aug. 31, 1979) (notice of appeal filed Oct. 17, 1979); *Employment Division v. Archdiocese of Portland,* 42 Or. App. 421, 600 P.2d 926 (1979); *Frankford Friends School v. Joseph,* No. 941 (Pa. Commw. Ct., filed Oct. 10, 1979); *Germantown Friends School v. Joseph,* No. 941 (Pa. Commw. Ct., filed Oct. 10, 1979); *Independent Baptist Church v. Tennessee,* Case No. 54227, (Ch. Ct. Hamilton County, Tenn., Mar. 23, 1979) (unpublished opinion); *Baptist Tabernacle v. Georgia Department of Labor,* Case. No. C-45866 (Fulton County Superior Court, Sept. 29, 1978) (unpublished opinion); *Lutheran Church-Missouri Synod v. Bowling,* Case No. 501-78 (7th Judicial Circuit, Sangamon County, Illinois, Nov. 15, 1979) (unpublished opinion).

In addition, various other state labor department appeal tribunals or state Attorney Generals have ruled church operated schools were exempt from coverage. Numerous other cases involving parochial schools are pending.

The significance of the federal questions involved and the extensive litigation occurring throughout the nation warrant resolution by the United States Supreme Court.

CONCLUSION

The petition for a writ of certiorari to the Supreme Court of the State of South Dakota should be granted.

Respectfully submitted,

Edward Thomas Schilling
757 North Broadway, Suite 500
Milwaukee, Wisconsin 53202
414/276-1122
and
Ernst J. von Briesen
757 North Broadway, Suite 500
Milwaukee, Wisconsin 53202
414/276-1122
Counsel for Petitioners

of counsel:

VON BRIESEN & REDMOND, S.C.
757 North Broadway, Suite 500
Milwaukee, Wisconsin 53202

July, 1980

APPENDIX A

IN THE SUPREME COURT
OF THE
STATE OF SOUTH DAKOTA

* * * *

IN THE MATTER OF THE DETERMINATION OF UNEMPLOYMENT INSURANCE COVERAGE OF NORTHWESTERN LUTHERAN ACADEMY AND ST. MARTIN'S EVANGELICAL LUTHERAN SCHOOL.

* * * *

APPEAL FROM THE CIRCUIT COURT OF THE
SIXTH JUDICIAL CIRCUIT
HUGHES COUNTY, SOUTH DAKOTA

* * * *

HONORABLE ROBERT A. MILLER
Judge

* * * *

JUDITH A. ATKINSON
Assistant Attorney General
Pierre, South Dakota

On the brief:
MARK V. MEIERHENRY
Attorney General
Pierre, South Dakota

Attorneys for appellant,
State of South Dakota

E. THOMAS SCHILLING
von BRIESEN & REDMOND, S.C.
Milwaukee, Wisconsin

RORY KING
SIEGEL, BARNETT, SCHUTZ,
O'KEEFE, JEWETT & KING
Aberdeen, South Dakota

Attorneys for appellees,
Northwestern Lutheran Academy
and St. Martin's Evangelical
Lutheran School.

* * * *

ARGUED October 10, 1979
OPINION FILED March 26, 1980

FOSHEIN, Justice

The State of South Dakota appeals from a judgment of the circuit court exempting respondents Northwestern Lutheran Academy and St. Martin's Evangelical Lutheran School from liability for payment of unemployment tax on their school personnel. We reverse.

Northwestern Lutheran Academy (NLA) is a four-year preparatory school for entrance to Northwestern College or Dr. Martin Luther College. At these latter institutions, students are trained for the ministry of the Wisconsin Evangelical Lutheran Synod. St. Martin's Evangelical Lutheran School (St. Martin's) is an elementary school operated by St. Martin's Evangelical Lutheran Church.[1] Both respondent schools have four or more employees exclusive of those found to be or-

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[1] NLA, owned and operated by the Wisconsin Synod, and St. Martin's Church, separately incorporated as a church under South Dakota law, are both members of the Wisconsin Synod and exempt from income tax liability under Section 501 of the Internal Revenue Code (26 U.S.C.A. §501) (1967)).

dained, commissioned or licensed ministers in the exercise of their ministry.

Prior to January 1, 1978, the Federal Unemployment Tax Act (FUTA) permitted states to exempt certain services from taxation.[2] These exemptions from unemployment tax liability were codified in South Dakota in SDCL 61-1-10.4, which provided that employment covered did not include services performed:

(1) In the employ of

(a) a church or convention of association of churches, or

(b) an organization which is operated primarily for religious purposes and which is operated, supervised, controlled, or principally supported by a church or convention or association of churches; or

(2) By a duly ordained, commissioned, or licensed minister of a church in the exercise of his ministry or by a member of a religious order in the exercise of duties required by such order; or

(3) In the employ of a school other than a state school which is not an institution of higher education[.] . . .

---

[2] 26 U.S.C.A. §3301 et seq. FUTA is a comprehensive plan for unemployment compensation allowing for state and federal participation in its administration. Section 3301 of the Act imposes a federal unemployment tax, but Section 3302 of the Act permits tax credits against the federal tax for employers who have paid money into federally approved state unemployment tax funds. In order for a state to participate in the federal plan, it must meet certain requirements set out under Sections 3303 and 3304. While the respondents are exempted from the federal unemployment tax by Section 3306(c)(8), Sections 3304(a)(6) and 3309 require participating states to tax certain charitable organizations exempted from the federal tax.

In 1976 Congress amended FUTA[3] and, as requried by that amendment, the South Dakota Legislature in effect repealed subsection (3) of SDCL 61-1-10.4.

In April of 1978, the Secretary of Labor, charged with administration of FUTA, was called upon to determine whether church-related schools were exempt from state unemployment tax under Section 3309(b)(1) (corresponding to SDCL 61-1-10.4(1)). The Secretary's opinion, announced in a letter of April 18, 1978, addressed to the Most Reverend Thomas C. Kelly, General Secretary of the United States Catholic Conference, declared:

> The repeal by Congress of the exclusion, in Section 3309(b)(3) of the Federal Unemployment Tax Act, of employees of elementary and secondary schools was clearly intended to result in State coverage of church related schools, whose employees constitute over 80% of the employees of all non-profit schools. In light of the repeal of 3309(b)(3), we think the only services performed in the schools that may reasonably be considered within the scope of the exclusion permitted by 3309(b)(1) are those strictly church duties performed by church employees pursuant to their religious responsibilities within the school.

The Secretary's opinion resulted in a directive issued to all state employment agencies participating in the federal program, requiring such agencies to be able to assess unemployment compensation taxes against church-related schools in their states. The extension of this coverage under state law is a mandatory condition precedent to certification by the Secretary of Labor that the state

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[3] The Unemployment Compensation Amendments Act of 1976, Pub. L. No. 94-566, 90 Stat. 2667.

statute conforms to federal standards; the Secretary's certification, in turn, provides access to the system of tax credits and federal reimbursement of certain benefit costs.

The State of South Dakota, in order to continue its participation in FUTA, issued a determination that both NLA and St Martin's School are employers subject to coverage by the South Dakota Unemployment Insurance Law. This decision was reviewed by the Appeals Referee for the South Dakota Department of Labor whose decision found the schools subject to coverage, but that pastors and male teachers were exempt from coverage as ministers of a church in the exercise of their ministry, under SDCL 61-1-10.4(2). On appeal to the circuit court, the Appeals Referee was reversed and NLA and St Martin's were both found to be exempt from coverage under the South Dakota Unemployment Insurance Law.

I

[1] The threshold question on appeal involves a determination of congressional intent with respect to the repeal of Section 3309(b)(3) of FUTA (which resulted in the effective repeal of SDCL 61-1-10.4(3)). Respondents submit that the removal of the exclusion from unemployment compensation tax liability for school employment was meant only to extend coverage to private, nonparochial schools and did not affect the exclusion from coverage of parochial schools. An examination of the recent legislative background of FUTA, however, indicates otherwise. The Employment Security Amendments of 1970, by adding new language to various sections of FUTA[4], required state law coverage of individ-

[4] §§3304(a)(6), 3306(c)(8) and 3309(a)(1)(A)

uals employed by nonprofit organizations (including institutions of higher education). The committee reports accompanying the amendments demonstrate that Congress intended to extend coverage to individuals employed in nonprofit organizations including religious organizations The House Ways and Means Committee explained that:

> Under existing Federal law, services performed for nonprofit *religious, charitable, educational* and humane organizations for a State and its political subdivisions are exempt from the tax provisions of the Federal Unemployment Tax Act. While employment in these organizations and governments is not subject to fluctuations to the same degree as in commerce and industry, unemployment affects a substantial number of their employees, particularly people working in nonprofessional occupations. Your committee does not want to change the present tax status of nonprofit organizations, but it is concerned about the need of their employees for protection against wage loss resulting from unemployment.

H.R.Rep.No. 612, 91 Cong., 1st Sess. 11 (1969). (emphasis supplied). The Committee went on to delineate more clearly the limits of the Section 3309(b)(1) exemption (correlative to SDCL 61-1-10.4(1)) as applied to institutions of higher education:

> This paragraph excludes services of persons where the employer is a church or convention of association of church, but does not exclude certain services performed for an organization which may be religious in orientation unless it is operated primarily for religious purposes and is operated, supervised, controlled, or principally supported by a church or (convention or association of churches). Thus, services of the janitor of a church would be excluded but services of a janitor for a separately incorporated college, although it may be church related, would

> be covered. A college devoted primarily to preparing students for the ministry would be exempt, as would a novitiate or house of study training candidates to become members of religious orders. On the other hand, a church related (separately incorporated) charitable organization (such as, for example, an orphanage or a home for the aged) would not be considered under this paragraph to be operated primarily for religious purposes.

H.R.Rep.No. 612, 91 Cong., 1st Sess. 44 (1969). Identical language is found in S.Rep.No. 752, 91 Cong., 2nd Sess. (1970), at 48-59, U.S. Code Cong. & Admin. News 1970, p. 3606.

We conclude from our reading of the 1970 congressional revisions and the accompanying legislative reports that Congress expected the "operated primarily for religious purposes" language in section 3309(b)(1)(B) (corresponding to that in SDCL 61-1-10.4(1)(b)) to be narrowly construed, at least as applied to educational institutions. The Department of Labor has adhered to this congressional mandate and consistently interpreted the 1970 amendments as requiring state unemployment coverage of all institutions of higher education except for the narrow category including seminaries and novitiates which are devoted exclusively to religious training and indoctrination.

In view of Congress' apparent intention in 1970 to bring religiously affiliated institutions of higher education within coverage, and in light of the Labor Department's subsequent adoption of this interpretation, Congress' description of the objective behind the 1976 repeal of Section 3309(b)(3) (culminating in the repeal of SDCL 61-1-10.4(3)) is informative. According to Congress, the repeal of this section "has the effect of requiring

the State to pay unemployment compensation on the basis of services performed for *all* educational institutions. Under existing law, the State is only required to provide coverage of services performed for institutions of higher education." H.R.Rep.No. 755, 94th Cong., 1st Sess. 6 (1975). (emphasis supplied). As stated in the Senate Report on the bill:

> The bill would require the State to extend the coverage of their unemployment compensation programs to employees of nonprofit elementary and secondary schools (present law requires coverage for employees of institutions of higher education). The provisions for nonpayment of benefits during vacation periods to school employees of State and local governments would also apply to employees of nonprofit schools.

S.Rep.No. 1265, 94th Cong., 2d Sess. 2 (1976), U.S. Code Cong. & Admin. News, pp. 5997, 5998.

It is further significant that S.Rep.No. 1265, 94th Cong. 2d Sess., 8 (1976) estimated the number of new employees who would be covered as a result of the repeal of Section 3309(b)(3) at 242,000. This figure approximates the total number of teachers in all nonprofit elementary and secondary schools. Absent the inclusion of employees of church-related elementary and secondary schools, the figure would be considerably less than 242,000, because the teachers in such schools comprise more than half of the staff of all nonpublic and elementary and secondary schools in the United States.[5]

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[5] According to the Census Bureau's *Statistical Abstract of the United* States (1977), there were 261,000 full-time teachers in nonprofit elementary and secondary schools in 1975 of which 150,000 were in Roman Catholic Schools. Thus, it is clear that Congress contemplated that the repeal of §3309(b)(3) would bring all elementary and secondary schools within the ambit of FUTA.

[2] Moreover, when faced with the problem of statutory construction, we must show great deference to the interpretation given such statutes by the agency charged with their administration. *Udall v. Tallman,* 380 U.S. 1, 85 S.CT. 792, 13 L.Ed.2d 616 (1965). Shortly after the enactment of the 1970 amendments, the Department published its interpretation of those amendments which stated that the exemption for services performed for churches or religious organizations did not extend to services performed for religiously affiliated institutions of higher education. The Department's view of the objective behind the 1976 amendments, expressed in the Secretary's letter, supra, is a logical and necessary extension of the position which the Department has taken without objection since 1970. We find further significance in the fact that Congress did not attempt in 1976 to alter the Department's interpretation of §3309(b)(1). The "failure of Congress to alter or amend . . . [a] section, notwithstanding this consistent construction by the department charged with its enforcement, creates a presumption in favor of the administrative interpretation, to which we should give great weight even if we doubted the correctness of the ruling of the Department of Labor". *Costanzo v. Tillinghast,* 287 U.S. 341, 345, 53 S.Ct. 152, 154, 77 L.Ed. 350, 353 (1932).

II

[3-5] Having arrived at this determination of congressional intent, we must decide whether the South Dakota Unemployment Compensation Law infringes respondents' freedom of religion guaranteed by the First Amendment to the United States Constitution and Article VI, Section 3 of the South Dakota Constitution. In order to demonstrate that legislation conflicts with the Free

Exercise Clause, "it is necessary . . . for one to show the coercive effect of the enactment as it operates against him in the practice of his religion." *School District of Abington v. Schempp,* 374 U.S. 203, 223, 83 S.Ct. 1560, 1572, 10 L.Ed.2d 844, 858 (1963). Although the First Amendment protection of religious belief is absolute, religiously-based conduct "remains subject to regulation for the protection of society." *Cantwell v. Connecticut,* 310 U.S. 296, 303-304, 60 S.Ct. 900, 903, 84 L.Ed. 1213, 1218 (1940). Thus, legislation that inhibits conduct mandated by religious convictions, if justified by "interests of the highest order and those not otherwise served can overbalance legitimate claims for the free exercise of religion." *Wisconsin v. Yoder,* 406 U.S. 205, 215, 92 S.Ct. 1526, 1533, 32 L.Ed.2d 15, 25 (1972).

[6] Respondents do not outline any specific religious beliefs, or practices that conflict with inclusion of their school personnel in the unemployment compensation program. Assuming, however, that their claim relates to the alleged financial burden that FUTA places upon them they yet fail to meet their burden of demonstrating a violation of the Free Exercise Clause. The United States Supreme Court has refused to invalidate laws on free exercise grounds simply because they operate "so as to make the practice of . . . religious beliefs more expensive." *Braunfeld v. Brown,* 366 U.S. 599, 605, 81 S.Ct. 1144, 1147, 6 L.Ed. 563, 567 (1961). Neither does the unemployment insurance coverage in this case work in any manner to change the entire way of life of any persons associated with respondents. Cf., *Wisconsin v. Yoder, supra.* It is further significant that employers may meet their obligation by making reimbursement payments in lieu of contributions into the state unemployment compensation fund. See: §3304(a)(6)(b); §3309

(a)(2). An employer electing the reimbursement method is liable only for those amounts paid out to former employees in the form of benefits. Such benefits are not automatically paid to all individuals who become unemployed; rather, certain eligibility requirements must be met before benefits are received and liability is incurred by an employer. This method, by which it is conceivable that no liability may occur, can not be characterized as "coercive" since it will have little, if any, impact upon respondents' religious practices.

Further, coverage of parochial school employees under the unemployment compensation tax law is permissible because it is justified by a compelling governmental interest. This interest is to provide a system of income maintenance for unemployed individuals so that they have the resources for food, shelter, and other necessities of life until they are able to secure other employment (or until the expiration of the statutorily prescribed period for the receipt of benefits). The United States Supreme Court has repeatedly upheld social and regulatory programs which feature important governmental interests, even though such programs may have an incidental effect upon free exercise of religion. *Braunfeld v. Brown, supra; McGowan v. Maryland,* 366 U.S. 420, 81 S.Ct. 1101, 6 L.Ed.2d 393 (1961); *Prince v. Massachusetts,* 321 U.S. 158, 64 S.Ct. 438, 88 L.Ed. 645 (1944); *Reynolds v. United States,* 98 U.S. 145, 25 L.Ed. 244 (1878). Of further relevance are cases which have held that the failure to grant tax exemptions to religious organizations did not violate the free exercise clause. See, e.g., *Watchtower Bible and Tract Society v. Los Angles County,* 181 F.2d 739 (9th Cir. 1950), *cert. denied,* 340 U.S. 820, 71 S.Ct. 51, 95 L.Ed. 602 (1950) (upholding state personal property tax levy upon religious litera-

ture). As noted in *Parker v. Commissioner,* 365 F.2d 792, 795 (8th Cir. 1966), *cert. denied,* 385 U.S. 1026, 87 S.Ct. 752, 17 L.Ed.2d 674 (1967):

> The receiving of an exemption is thus a matter of legislative grace and not a constitutional right. As long as exemptions are denied by the Commissioner upon a non-discriminatory basis using specific and reasonable guidelines and without inquiry into the merits of the particular religious doctrines, the withholding of religious exemptions is permissible under the Constitution.

Because the Secretary's interpretation of the amended statute, *supra,* avoids inquiry into the merits of any particular religious doctrine and will result in nondiscriminatory enforcement of FUTA as applied to all nonprofit elementary and secondary schools, the interpretation does not violate the Free Exercise Clause.

In *Mitchell v. Pilgrim Holiness Church Corp.,* 210 F.2d 879 (7th Cir. 1954), *cert. denied,* 347 U.S. 1013, 74 S.Ct. 867, 98 L.Ed. 1136 (1954), the court held that refusal to comply with the federal minimum wage law cannot be justified on religious grounds. The court there stated that the Fair Labor Standards Act "does not . . . *prohibit* the free exercise of religion by the defendant nor does it *lay a flat tax* on the privilege" (emphasis in orignial). 210 F.2d at 883. The court went on to state that the remedial character of the Fair Labor Standards Act — "to insure to the workers of the United States engaged in the production of goods for commerce a minimum wage sufficient to maintain a minimum standard of living" — justified any incidental impact upon their employer's free exercise of religion. *Id.,* at 884. Similarly, in the present case, unemployment insurance coverage will have no more than a minimal impact on any religious practice. Further, the purposes of the un-

employment compensation program — to insure that eligible persons will be able to maintain a minimum standard of living and that the detrimental effects of such unemployment will not have an adverse effect on the economy — are sufficiently compelling to override any incidental burden upon respondents' activities.

III

Respondents contend that removal of the exemption would foster excessive entanglement between church and state in violation of the First Amendment. It is true that the inclusion of certain employees under the state's unemployment insurance law will necessarily call for increased involvement between the state and the schools. Such involvement, however, does not constitute excessive entanglement violative of the First Amendment. As the United States Supreme Court has noted, it has never been thought either possible or desirable to enforce a regime of total separation between church and state; thus, the high wall of separation in modern interpretation has become "a blurred, indistinct, and variable barrier depending on all the circumstances of a particular relationship". *Lemon v. Kurtzman,* 403 U.S. 602, 614, 91 S.Ct. 2105, 2112, 29 L.Ed.2d 745, 756 (1971).

[7-8] It is clear from decisions of the Supreme Court that programs which require constant state surveillance or supervision to police the provisions of state programs or that single out church-related schools for preferential treatment will not be tolerated. *Wolman v. Walter,* 433 U.S. 229, 97 S.Ct. 2593, 53 L.Ed.2d 714 (1977); *Tilton v. Richardson,* 403 U.S. 672, 91 S.Ct. 2091, 29 L.Ed.2d 790 (1971); *Walz v. Tax Commission,* 397 U.S. 664, 90 S.Ct. 1409, 25 L.Ed.2d 697 (1970); *Everson v. Board of Education,* 330 U.S. 1, 67 S.Ct. 504, 91 L.Ed. 711

(1947). Any entanglement between church and state in the present case does not reach the level of that which was struck down in *Lemon v. Kurtzman, supra.* In that case, state statutes provided state reimbursement to non-public elementary and secondary schools for the cost of teacher's salaries, textbooks and instructional materials. Under one statute, participating schools were requried to identify the cost of secular educational service by prescribed accounting procedures that were subject to state audit. The other statute provided annual salary supplements to teachers of secular subjects in non-public elementary school. The teachers were required to sign a written statement agreeing not to teach religious courses while receiving salary supplements, and were required to teach only subjects taught in public schools, using the same materials. Such statutes were found to create excessive entanglement because comprehensive and continuing state surveillance would be required to insure that the programs' provisions were obeyed. In the present case, respondents contend that because different benefits accrue to those employees that are laid off and those that are fired, the state will necessarily become involved in questions of doctrinal interpretation. Such is not the case. The teachers in respondents' schools are not under contract; rather, they receive a "call" from the church and there are only two ways that a teacher may be released from that call. One is by teaching false doctrine and the other is by misconduct as outlined by respondents' own standards. In both cases, the rules relating to dismissal are regulated by internal doctrinal matters controlled by the church. The state, therefore, need only determine whether the employee was fired or laid off. The employee, as before, will be left to the mercy of respondents' personnel practices.

Respondents also rely on *National Labor Relations Board v. Catholic Bishop of Chicago,* 440 U.S. 490, 99 S.Ct. 1313, 59 L.Ed.2d 533 (1979). The issue in that case was whether an NLRB attempt to exercise jurisdiction over diocesan schools to determine whether a particular personnel practice constituted an unfair labor practice fostered excessive entanglement between church and state. The Seventh Circuit United States Court of Appeals held in the affirmative. The Supreme Court stated that the resolution of such a question "in many instances, [would] necessarily involve inquiry into the good faith of the position asserted by the clergy-administrators and its relationship to the school's religious mission" and thus create excessive entanglement. 99 S.Ct. at 1320. While noting the risks of entanglement inherent in such a relationship, however, the Court declined to decide the First Amendment question in the absence of a clear expression of an affirmative intention of Congress to bring teachers and employees in church-related schools within NLRB jurisdiction. The majority's extended discussion of the entanglement question nonetheless suggests that had such congressional intent been found to exist, serious issues of constitutional magnitude would arise. The minimal entanglement that might result in the present case, however, does not approach the potential effect, noted in *Catholic Bishop,* of mandatory collective bargaining on the ability of clerical authorities to administer their schools. In no case would the state be required to actually adjudicate employer/employee disputes in a sectarian school setting. Unemployment insurance coverage does not necessitate state involvement in the development of curriculum, faculty standards, working conditions or any other aspect of school operations. The unemployment insurance system would generally come

into play only after an employee had been terminated and was no longer connected in any way with the particular school. Further, the financial impact of the unemployment insurance compensation law cannot be compared with the financial ramifications of NLRB jurisdiction over diocesan schools. In the case of the NLRB, there exists power to order reinstatement with back pay and to utilize judicial authority to enforce its ruling. The state has no such power in the present case. We also note that the simple determination of the amount of time spent by employees working in respondents' schools, as opposed to its churches, does not foster entanglement of constitutional dimensions.

IV

[9] Finally, respondents contend that female teachers are exempt from coverage as members of a religious order under SDCL 61-1-10.4(2). Respondents argue that such teachers cannot be denied exempt status, because the Synod dogmatically considers its female teachers to be part of its Christian ministry. The fact, however, is that female teachers in respondents' schools are not permitted to perform any sacerdotal duties or to vote on Synod matters; rather, they are allowed to perform only those functions normally associated with basic education. Thus, their coverage under the unemployment compensation law is appropriate.

The judgment of the circuit court is reversed and the case is remanded with directions to reinstate the decision of the Appeals Referee.

WOLLMAN, C. J., and DUNN and MORGAN, JJ., concur.

HENDERSON, J., dissents.

HENDERSON, Justice (dissenting).

I respectfully dissent.

The object and purpose of the Wisconsin Evangelical Lutheran Synod, as set forth in its constitution, is to "extend and conserve the true doctrine and practice of the Evangelical Lutheran Church." One method of achieving this is by "establishing and maintaining theological seminaries, colleges, academies, schools, and other institutions." The Synod believes a theological basis exists for its schools. It holds the conviction that training of the youth involves both education and religion and the two are so closely interwoven that they cannot be separted. They operate school programs in accordance with their beliefs.

The Synod has 1105 churches of which 330 operate elementary Christian day schools. St. Martin's Evangelical Lutheran School, appellee, is one of these 330 elementary schools. The Synod also maintains two types of secondary schools: (1) Area high schools, designed to provide a Christian education to students at this level, and (2) Academies, structured to provide secondary education for individuals planning to enter the preaching or teaching ministry of the Church. Northwestern Lutheran Academy, appellee, is one of four such academies maintained by the Synod. The Synod has both teaching and preaching ministers. These ministers and teachers receive similar religious training; both receive, they sincerely believe, a divine, life-long call to serve their church and God. The Synod considers the female teachers to be part of the ministry and they have responsibilities equal to that of the male teachers. Courses offered

at the school and at the academy are taught from a religious viewpoint based upon scriptural convictions held by members of the Wisconsin Evangelical Lutheran Synod. The school is financed 100% by the local congregation. The Synod owns, operates, and finances the academy.

Both the school and the academy are exempt from income taxation under Section 501(c)(3) of the Internal Revenue Code. In the past, they have also been exempted from Federal Unemployment Tax Act (FUTA) coverage by SDCL 61-1-10.4(3), which corresponds to 26 U.S.C. Section 3309(b)(3). SDCL 61-1-10.4, until recently, provided in pertinent part:

> 61-1-10.4 EXEMPT EMPLOYMENT BY CHURCHES, INSTITUTIONS AND STATES. — [f]or the purposes of Sections 61-1-10.2 and 61-1-10.3 the term "employment" does not apply to service performed:
>
> (1) In the employ of
>
> (a) a church or convention of association of churches, or
>
> (b) an organization which is operated primarily for religious purposes and which is operated, supervised, controlled, or *primarily supported by a church or convention or association of churches* (emphasis supplied); or
>
> (2) By a duly ordained, commissioned, or licensed minister of a church in the exercise of his ministry or by a member of a religious order in the exercise of duties required by such order; or
>
> (3) In the employ of a school other than a state school which is not an institution of higher education prior to January 1, 1978.

The Unemployment Compensation Amendments Act of 1975, P.L. 94-566, 90 Stat. 2667, removed the sub-

section (3) exemption. Memoranda were thereupon sent to state employment security agencies by the U.S. Department of Labor, directing that all "church-related nonprofit elementary and secondary schools" be required to participate in the program. I am not bound by the interpretation of a bureaucrat in a government agency in Washington, D.C.

At a hearing conducted by the Field Service of the South Dakota Department of Labor, Unemployment Insurance Division, it was held that both schools were employers subject to S.D. unemployment insurance laws. Neither am I bound by a state employee's interpretation of congressional action. That determination was appealed and a hearing was held on July 19, 1978, before a Labor Department appeals referee. In his decision, entered September 15, 1978, the referee affirmed the initial determination that the schools were employers subject to coverage. To put it another way, each echelon of bureaucracy within the Department of Labor upheld itself. The circuit court, on appeal, reversed the referee upon the basis that the decision was affected by error of law in a misapplication of law and clearly erroneous in light of the entire evidence in the record. I would affirm the circuit court.

Counsel for appellees contend that they are exempt under SDCL 61-1-10.4 because of their relationship to a church. The state maintains that the repeal of the subsection (3) exemption for non-public schools was aimed at church schools as well as secular schools. The appeals referee concluded that a "church," as used in the statute, was synonymous with a "house of worship" rather than an organization of worshippers. This interpretation is most untenable when noting the context

in which "church" is used. SDCL 61-1-10.4(1)(a) speaks of services performed in the employ of a church. If the term "church" in isolation is ambiguous, the context of this statute absolutely forecloses equation with a physical plant. Clear error was committed when the appeals referee defined the term in such a manner as to make the statute absurd and ineffectual under any circumstance. When subsection (3), relating to private school coverage was repealed, Congress had a perfect opportunity to modify or remove the church-related exclusions. That was not done. The fact that the definition of church embodies an organization, rather than an edifice, strongly indicates that SDCL 61-1-10.4(1) exemptions remain valid and useful. In 1954, the question of defining the term "church" arose before the U.S. Senate. The Senate Finance Committee in its report observed:

> Your committee understands that 'church' to some denominations includes religious orders as well as other organizations which as integral parts of the church are engaged in carrying out the functions of the church *whether as separate corporations or otherwise. It is believed the term church should be all inclusive.* (Senate Report No. 1622, 83rd Congress, 2nd Session, page 30) (emphasis added)

In 1955, the staff of the Joint Conference Committee published its explanation of the Internal Revenue Code of 1954, entitled, "Summary of the Provisions of the Internal Revenue Code of 1954. (H.R. 8300) as Agreed to by the conferees." On page 19 the staff explained:

> The term church is intended to include religious orders as well as other organizations which, as integral parts of the church, are engaged in carrying out the functions of the church, whether as separate corporations or otherwise.

With respect to FUTA, the legislative history gives no support whatever to a narrower definition of the term "church" other than being all inclusive and including integral parts of the church, such as the parochial school. Congress, when passing FUTA amendments, clearly understood its interpretation of the word "church."

The question thus becomes whether either or both of the schools fall within the subsection (1) exemptions. St. Martin's Evangelical Church School is not a separate entity of St. Martin's Evangelical Church. Appellants are attempting to cleave the school from the church and this cannot be done. The appeals referee found that while the school was state certified the school was supervised by a board of education elected from and by the local congregation. South Dakota requires accreditation of any school serving children under the age of sixteen in lieu of attending public schools. Inasmuch as religious schools must be state certified, this state requirement should not be the basis of labeling them strictly educational. Finance and supervision provide the critical nexus between church and school, which places the latter squarely within the SDCL 61-1-10.4(1)(b) exemption for services performed in the employ of an organization. The school is operated primarily for religious purposes and is operated, supervised, controlled or principally supported by the church. This is the heart of my dissent. The congregation of St. Martin's Church supports public schools, located within a reasonable proximity, through the payment of taxes; the only rational reason that it would bear the additional burden of operating and financing a private school would be for religious purposes. A clear error was committed by the appeals referee in concluding that the primary purpose of the school was not religious.

Northwestern Lutheran Academy's teaching faculty comes 50% from the teaching ministry and 50% from the preaching ministry. Of the students at the academy, 46% go on to become teachers or pastors. The academy's remaining 54% nevertheless receive courses of instruction with religious overtones. Again, it must be recognized that public secondary schools exist in reasonable proximity and are supported by taxes paid by members of the Synod. It is obvious that these members send their children to a school which embraces their religious beliefs and where their children will be taught Christian values. The academy exists only for church purposes. The fact that the state imposes state certification does not change the character of the academy which is to propagate the faith of the Synod, and it is manifestly wrong for a state agency to subordinate that mission.

Any attempt to subject appellees, who are religious organizations operating religious schools, to an unemployment compensation law would be an impermissible entanglement between the church and state contrary to the First Amendment to the Constitution of the United States and Article VI, Section 3 of the South Dakota Constitution which provides for freedom of religion. The First Amendment provides in part: "Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof. . . ."

Under the unemployment compensation law, an employee who is laid off from work is entitled to unemployment compensation benefits, but an employee discharged for misconduct may be denied benefits. The majority opinion alludes to the fact that the only two ways a teacher may be released for cause is by teaching false doctrine and by misconduct as outlined by appellee's

own standards. It concludes that since rules relating to dismissal are regulated by internal doctrinal standards controlled by the church, there would only be minimal entanglement because the state has only to determine whether the employee was fired or laid off. This matter of potential entanglement cannot be so cursorily treated. Let us hypothesize that the Synod discharged an employee citing the reason as teaching contrary to school doctrine or misconduct, but the employee contends that the real reason for the discharge was due to budgetary concerns, and therefore, he or she was merely laid off. This employee could request a hearing to determine if he or she was entitled to full benefits. Granted, while the entanglement would not reach the proportions as that found in *N.L.R.B. v. Catholic Bishop of Chicago,* 440 U.S. 490, 99 S.Ct. 1313, 59 L.Ed.2d 533 (1979), such a hearing would nonetheless involve the question of whether the teacher did or did not teach contrary to Synod doctrine or on what basis, according to doctrinal standards, the employee's action constituted misconduct. The hearing examiner would have to rule on these matters of religious belief and misconduct, which is the kind of entanglement prohibited by the First Amendment to the Constitution.

The power to tax, surveil, and supervise this program is the power to destroy parochial schools. This program is another insidious spoke in the web of entanglement which chokes the free spirit of religious schools and their ability to function in their dedication to God. If religious schools are mandated into state and federal programs which exact money from them at governmental statutory whim, they shall die. They cannot coexist with governmental interference and over-lay. Our forefathers fled to these shores that they might worship as they please

and to raise their children in their own religious faith. I do not believe in a system of government, congressional acts, state statutes, or legal interpretations by the judiciary that would destroy that dream. The Constitution is a bulwark against state invasion of religiously based schools. In it, I abide.

I do not believe that Congress intended the tax to be applicable to the services of church operations run directly by the church with its own employees. For a persuasive case in point, with the same basis issues and statutes and a result contrary to the majority opinion, see *The Lutheran Church, Missouri Synod, et al. v. State of California Employment Development Department, et al.,* (Case No. CV79-0162-MRP before the United States District Court, Division of California, Opinion rendered September 21, 1979).

APPENDIX B

IN CIRCUIT COURT
SIXTH JUDICIAL CIRCUIT

STATE OF SOUTH DAKOTA)
) ss.
COUNTY OF HUGHES)

In the Matter of the Determination
of Unemployment Insurance Coverage
of Northwestern Lutheran Academy
and St. Martin's Evangelical
Lutheran Church School

MEMORANDUM DECISION

This is an administrative appeal in which two church affiliated schools seek reversal of an employment insurance hearing officer's decision that certain employees of the schools are covered by the South Dakota Unemployment Insurance Law.

FACTS AND PROCEDURAL HISTORY

Northwestern Lutheran Academy is a four year preparatory school located in Mobridge, South Dakota. It is owned and operated by the Wisconsin Evangelical Lutheran Synod, but is not separately incorporated as a church. It has more than four employees who are not duly ordained, commissioned, or licensed ministers in the exercise of their ministry.

St. Martin's Evangelical Lutheran Church is located in Watertown, South Dakota, and is incorporated as a church under the laws of this state. The church operates an elementary school which employs four female teachers and three other employees, none of whom are

duly ordained, commissioned or licensed ministers in the exercise of their ministry.

Both schools are exempt from income taxation under Section 501(c)(3) of the Internal Revenue Code. They have in the past been exempted from Federal Unemployment Tax Act (FUTA) coverage by SDCL 61-1-10.4 (3), which corresponds to 26 USC Section 3309(b)(3). SDCL 61-1-10.4 until recently provided in pertinent part:

> 61-1-10.4 EXEMPT EMPLOYMENT BY CHURCHES, INSTITUTIONS AND STATES. —for the purposes of Section 61-1-10.2 and 61-1-10.3 the term "employment" does not apply to service performed:
>
> (1) In the employ of
>
> (a) a church or convention or association of churches, or
>
> (b) an organization which is operated primarily for religious purposes and which is operated, supervised, controlled, or principally supported by a church or convention or association of churches; or
>
> (2) By a duly ordained, commissioned, or licensed minister of a church in the exercise of his ministry or by a member of a religious order in the exercise of duties required by such order; or
>
> (3) In the employ of a school other than a state school which is not an institution of higher education prior to January 1, 1978.

The Unemployment Compensation Amendments Act of 1975, P.L. 94-566, removed the subsection (3) exemption. Memoranda were thereupon sent to state employment security agencies by the U.S. Department of Labor, directing that all "church-related nonprofit ele-

mentary and secondary schools" be required to participate in the program.

At a hearing conducted by the Field Service of the South Dakota Department of Labor, Unemployment Insurance Division, it was held that both schools were employers subject to S.D. unemployment insurance laws. That determination was appealed and a hearing was held on July 19, 1978, before a Labor Department appeals referee. In his decision entered September 15, 1978, the referee affirmed the initial determination that the schools were employers subject to coverage.

QUESTIONS PRESENTED

I.

ARE THE SCHOOLS EXEMPT FROM UNEMPLOYMENT TAX LIABILITY BY LAW, BECAUSE OF THEIR ASSOCIATION WITH CHURCHES?

II.

IF THE SCHOOLS ARE NOT EXEMPT, DOES THE FAILURE TO EXEMPT THEM VIOLATE CONSTITUTIONAL PROHIBITIONS AGAINST ENTANGLEMENT OF CHURCH AND STATE?

DECISION

This is another controversy between the federal government and other entities in which the state finds itself caught in the middle. If it does not adopt the interpretation urged by the U.S. Department of Labor, the state ostensibly faces loss of federal money or credit under FUTA. If that interpretation is adopted, schools

found to be ineligible for public assistance in various "paroch-aid" cases must now pay taxes for employment security for some employees. Either the state or the schools must lose, while the federal agency which caused the conflict is unaffected.

The law that must be applied in the first instance is SDCL 61-1-10.4, as previously set forth, and SDCL 61-1-10.3. The latter statute provided in pertinent part:

> 61-1-10.3 COVERED EMPLOYMENT BY RELIGIOUS, CHARITABLE, EDUCATIONAL OR OTHER ORGANIZATION. — "Employment" includes services performed after December 31, 1971, by an individual in the employ of a religious, charitable, educational or other organization, but only if the following conditions are not excluded from "employment" under subdivisions (1), (2), (3), (4) or (5) of §61-1-10.4:
>
> (1) The service is excluded from "employment" as defined in the Federal Unemployment Tax Act solely by reason of section 3306(c)(8) service performed in the employ of a religious, charitable, educational, or other organization described in section 501(c)(3) which is exempt from the income tax under 501(a) of the federal act; and
>
> (2) The organization had four or more individuals in employment for some portion of a day in each of twenty different weeks, whether or not such weeks were consecutive, within either the current or preceding calendar year, regardless of whether they were employed at the same moment of time.

These state statutes reflect provisions of the federal statutes governing coverage, so those laws will not be restated herein. The constitutional provisions to be con-

sidered include the first and fourteenth amendments to the U.S. Constitution and Article VI, section 3 of the South Dakota Constitution. Those clauses provide, respectively:

> Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof; or abridging freedom of speech, or of the press; or the right of the people peaceably to assemble and to petition the government for a redress of grievances.
>
> * * *
>
> . . . No state shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States, nor shall any state deprive any person of life, liberty or property, without due process of law, nor deny to any person within jurisdiction of the equal protection of the laws . . .
>
> * * *
>
> The right to worship God according to the dictate of conscience shall never be infringed. No person shall be denied any civil or political right, privilege or position on account of his religious opinions; but the liberty of conscience hereby secured shall not be construed as to excuse licentiousness, the invasion of the rights of other, or justify practices inconsistent with the peace or safety of the state.
>
> No person shall be compelled to attend or support any ministry or place of worship against his consent nor shall any preference be given by law to any religious establishment or mode of worship. No money or property of the state shall be given or appropriated for the benefit of any sectarian religious society or institution.

I.

ARE THE SCHOOLS EXEMPT FROM UNEMPLOYMENT TAX LIABILITY BY LAW, BECAUSE OF THEIR ASSOCIATION WITH CHURCHES?

Counsel for the schools contends that they are exempt under statute because of their relationship to a church. The position of the State Department of Labor is that the repeal of the subsection (3) exemption for non-public schools was aimed at church schools as well as secular schools. The decision of the appeals referee adopted the state's rationale, and that decision is now alleged to be clearly erroneous, arbitrary and capricious, and affected by error of law. It is therefore necessary to consider the referee's decision in the context of applicable statute.

The appeals referee concluded that "church" as used in the statute was synonymous with a "house of worship" rather than an organization of worshippers. One need only note the context in which "church" appears to see how untenable this position is. SDCL 61-1-10.4(1)(a) speaks of services performed in the employ of a church. If the term "church" in isolation is ambiguous, the context of this statute absolutely forecloses equation with a physical plant. Clear error was committed when the appeals referee defined the term in such a manner as to make the statute absurd and ineffectual in any circumstance.

The state's brief clearly establishes a trend of widening employee coverage by unemployment taxation laws. The state urges construction of the statute in light of the purposes it seeks to achieve and the evils it seeks to remedy. Legislative history is presented at length, including statistical information that reveals that impact

on church-related schools was considered. Finally it is argued that this Court should defer to the administering agency's construction of the law in question.

This Court must decline the state's invitation to look behind the apparent meaning of the "employ of a church" exception. The state's position appears to be premised upon the act of repealing the private school exemption rather than upon the remaining statute. This Court will not indulge in statutory construction where no ambiguity appears in the statute. *Osaka Shosen Kaisha Line v. United States,* 300 U.S. 98, 81 L.Ed. 532 (1936). It is not permissible to create obscurity in statute for the purpose of invoking constructoin. *Minneapolis, St. Paul and S. Ste. M. R. C. v. Industrial Commission,* 153 Wis. 552, 141 N.W. 1119 (1913). When subsection (3), relating to private school coverage, was repealed, Congress had a perfect opportunity to modify or remove the church-related exclusions That was not done, and in fact coupled with the definition of church as an organization rather than an edifice strongly indicates that SDCL 61-1-10.4(1) exemptions remain valid and useful.

The question thus becomes whether either or both of the schools fall within the subsection (1) exemptions. The schools are sufficiently different in services, goals and organization to merit individual attention.

St. Martin's Evangelical Church School, as has been previously noted, is not separately incorporated from St. Martin's Evangelical Church. The appeals referee found that, while the school was state certified, the school was supervised by a board of education elected from and by the local congregation. It was further determined that the school was 100% financed by the local congre-

gation, and that all courses offered at the school were taught from a religious viewpoint. Finance and supervision provide the critical nexus between church and school that places the latter squarely within the SDCL 61-1-10.4(1)(b) exemption for services performed in the employ of an organization which is operated primarily for religious purposes and which is operated, supervised, controlled or principally supported by a church. The congregation of St. Martin's Church supports public schools through its taxes, and the only rational reason that it would bear the additional burden of operating and financing a private school would be for religious purposes. In the absence of evidence of other purposes which a public school could not meet, a clear error was committed in concluding that the primary purpose of the school was not religious.

Although the purpose and organization of Northwestern Lutheran Academy differs somewhat from that of the St. Martin's School, it may still fit within the (1)(b) exemption. Again, the criteria are:

(a) operation, supervision, control or principal support by a church or convention or association of churches, and

(b) operation primarily for church purposes.

The appeals referee found that the academy was controlled and principally supported by the Wisconsin Evangelical Lutheran Synod. Webster's New Collegiate Dictionary defines synod as "a regional or national organization of Lutheran congregations." If this is not synonymous with "church", it is with "association of churches", and therefore the first criterion is satisfied.

The second inquiry is whether the academy is operated primarily for church purposes. Insofar as the academy recruits and trains ministers for the church, it operates exclusively for church purposes. The remaining 54% of the students receive, as in the case of the St. Martin's student, courses taught from a religious viewpoint. Because public secondary schools exist in reasonable proximity, are supported by taxes paid by individual members of the synod, and offer quality education, it must again be assumed that the reasons students attend the academy is something other than garden variety education. The academy operates for church purposes, and no amount of state certification or requirements can remove this salient element of the academy. When the only reason for separate existence found in the record is the propagation of the faith of the synod, the referee clearly errs in subordinating that purpose.

II.

IF THE SCHOOLS ARE NOT EXEMPT, DOES FAILURE TO EXEMPT THEM VIOLATE CONSTITUTIONAL PROHIBITIONS AGAINST ENTANGLEMENT OF CHURCH AND STATE?

It is not necessary to address the constitutional question here because applicable statute exempts the schools from state imposition of unemployment taxes. Similarly, the question of whether the female teachers are members of a religious order need not be considered.

CONCLUSION

The decision of the appeals referee will be reversed as affected by error of law and clearly erroneous in

light of the entire evidence in the record. Counsel for the schools is directed to prepare and submit a judgment in accordance with this decision.

Dated this 19th day of March, 1979.

BY THE COURT:

/s/ Robert A. Miller
Robert A. Miller
Presiding Circuit Judge

ATTEST:

.....
Clerk of Courts

(SEAL)

APPENDIX C

STATE OF SOUTH DAKOTA

BEFORE THE SOUTH DAKOTA DEPARTMENT OF LABOR — UNEMPLOYMENT INSURANCE DIVISION

IN THE MATTER OF THE DETERMINATION OF UNEMPLOYMENT INSURANCE COVERAGE OF NORTHWESTERN LUTHERAN ACADEMY AND ST. MARTIN'S EVANGELICAL LUTHERAN CHURCH SCHOOL

ADMINISTRATIVE DECISION

This matter has come on for hearnig upon appeals having been duly filed by Northwestern Lutheran Academy, Mobridge, South Dakota, and the St. Martin's Evangelical Lutheran Church School, Watertown, South Dakota, appealing from a determination issued by the Field Service of the South Dakota Department of Labor, Unemployment Insurance Division, holding both organizations were employers subject to coverage by the South Dakota Unemployment Insurance Laws.

Hearing was scheduled and held in Aberdeen, South Dakota, on July 19, 1978, at 9:00 a.m. Present at the hearing as witnesses were Rev. Elton H. Huebner, Executive Secretary, Board of Trustees, Wisconsin Evangelical Lutheran Synod; Rolland Menk, Principal, St. Martin's Evangelical Lutheran Church School; and Rev. Daniel Malchow, President, Northwestern Lutheran Academy. The Northwestern Lutheran Academy and the St. Martin's Evangelical Lutheran Church were represented by E. Thomas Schilling, Attorney at Law. The

Department of Labor was represented by Peter J. Pagones.

FINDINGS OF FACTS

I.

Northwestern Lutheran Academy and St. Martin's Evangelical Lutheran Church are members of the Wisconsin Evangelical Lutheran Synod and are both exempt organizations under Section 501(c)(3) of the Internal Revenue Code.

II.

The object and purpose of the Synod, as set forth in its constitution, is to "extend and conserve the true doctrine and practice of the Evangelical Lutheran Church." One method of achieving this is by "establishing and maintaining theological seminaries, colleges, academies, schools, and other institutions."

III.

The Synod believes a theological basis exists for their schools. It holds the conviction that training of the youth involves both education and religion and that the two are so closely interwoven they cannot be separated. They operate school programs in accordance with these beliefs.

IV.

Of the 1105 local churches in the Synod, 330 operate elementary Christian day schools. The school operated by St. Martin's Evangelical Lutheran Church is one of these Christian day schools.

V.

The Synod maintains two types of secondary schools. Area high schools are designed to provide a Christian

education to students at this level. The second type of schools, academies, are designed primarily to provide education at the secondary level to those individuals planning to enter the preaching or teaching ministry of the Church. Northwestern Lutheran Academy is one of four such academies maintained by the Synod.

VI.

The Wisconsin Evangelical Lutheran Synod has both teaching ministers and preaching ministers, or pastors.

VII.

Pastoral training normally includes four years at a Synod academy, four years at the college operated by the Synod, Northwestern College, and four years at the Synod seminary, Wisconsin Lutheran Seminary. Students can enter the program at the college level from other institutions.

VIII.

Teacher training consists of four years of high school, usually at a Synod academy, and four years at Dr. Martin Luther College, the Synod's teacher training college. Teachers must be certified by the Synod to teach in a church or Synod school.

IX.

Pastors and teachers receive similar religious training.

X.

The Synod considers preaching ministers and male teaching ministers to have equal status in the Church. Each has an equal vote on Synod matters, including matters of doctrine. Both can and do perform the sacer-

dotal functions of the Church. Both pastors and teachers are formally ordained in a very similar manner. Both receive a divine, life-long call to the position in which they are to serve and the specific duties performed in such position are determined by the calling body. Both share equally in various programs of the Church, such as the hospitalization and pension programs, are considered self-employed by the Internal Revenue Service, and have an exemption from Social Security coverage. In cases where the Church provides a residence for the teacher, most jurisdictions have exempted the residence from tax on the same basis that the pastor's residence is exempt.

XI.

The Synod also has female teachers whom they consider part of the ministry. The female teachers have responsibilities equal to that of male teachers, receive identical training, and also receive a divine, life-long call. The scriptural convictions of the Church, however, prevent the female teachers from performing the sacerdotal functions and from voting in Synod matters.

XII.

The school operated by St. Martin's Evangelical Lutheran Church is state certified and offers education in kindergarten through eighth grade. Overall supervision over the school is exercised by a Board of Education elected from and by the local congregation. The school is 100% financed by the local congregation and is not a separate legal entity from the Church.

XIII.

Paid staff members at St. Martin's Evangelical Lutheran School include two male teachers, four female

teachers, and three other employees, one of whom also works at the Church.

XIV.

All education courses offered at the School are taught from a religious viewpoint based on the Scriptural convictions held by members of the Wisconsin Evangelical Lutheran Synod.

XV.

Northwestern Lutheran Academy is a state certified institution offering education in grades nine through twelve. The Synod is the principal source of support for the School and controls the operation and policy of the School.

XVI.

The purpose of the Academy, as listed in their school catalog, is as follows: "Northwestern Lutheran Academy is an institution owned and operated by the Wisconsin Evangelical Lutheran Synod. The purpose which it endeavors to serve is twofold. In keeping with the ever-increasing need for future workers in the preaching and teaching ministry, the Academy endeavors to recruit and provide training for such prospective workers. At the same time, in line with the reasons for its establishment, it desires to make a general Christian education on the secondary level available to parents who desire such an education for their children."

XVII.

The Academy admits students other than those specifically preparing for the teaching and preaching ministry because its location in a sparsely populated area results in space being available for this type of student. The curriculum at the Academy does not include some courses

which would be available at the Synod's area high schools, such as home economics or industrial arts. Approximately 50% of Academy students are preparing to become teachers or pastors. Approximately 46% of Academy graduates go on to this work.

XVIII.

The Academy has more than four employees exclusive of the pastors and male teachers on the staff.

XIX.

Courses offered at the Academy are taught from the same religious viewpoint as the courses in the local elementary Christian day schools.

XX.

The teaching faculty at the Academy comes 50% from the teaching ministry and 50% from the preaching ministry.

XXI.

By Unemployment Insurance Program Letter number 39-78, dated 5-30-78, the states were directed by the U.S. Department of Labor to extend unemployment insurance coverage to employees of church-related nonprofit elementary and secondary schools.

LAW APPLICABLE

61-1-10.3 COVERED EMPLOYMENT BY RELIGIOUS, CHARITABLE, EDUCATIONAL OR OTHER ORGANIZATION. — "Employment" includes services performed after December 31, 1971, by an individual in the employ of a religious, charitable,

educational or other organization, but only if the following conditions are met, and if such services are not excluded from "employment" under subdivisions (1), (2), (3), (4) or (5) of Section 61-1-10.4:

(1) The service is excluded from "employment" as defined in the Federal Unemployment Tax Act solely by reason of section 3306(c)(8) (service performed in the employ of a religious, charitable, educational or other organization described in section 501(c)(3) which is exempt from the income tax under 501(a) of the federal act); and

(2) The organization had four or more individuals in employment for some portion of a day in each of twenty different weeks, whether or not such weeks were consecutive, within either the current or preceding calendar year, regardless of whether they were employed at the same moment of time.

61-1-10.4 EXEMPT EMPLOYMENT BY CHURCHES, INSTITUTIONS AND STATE — For the purposes of Sections 61-1-10.2 and 61-1-10.3 the term "employment" does not apply to service performed:

(1) In the employ of

(a) a church or convention or association of churches, or

(b) an organization which is operated primarily for religious purposes and which is operated, supervised, controlled, or principally supported by a church or convention or association or churches; or

(2) By a duly ordained, commissioned, or licensed minister of a church in the exercise of his ministry or by a member of a religious order in the exercise of duties required by such order; or

(3) In the employ of a school other than a state school which is not an institution of higher education prior to January 1, 1978.

OPINION

The Referee concludes the St. Martin's Evangelical Lutheran Church School and Northwestern Lutheran Academy are employers subject to the South Dakota Unemployment Insurance Laws but that the pastors and male teachers performing services for these organizations are exempt from coverage.

The organizations in question are an elementary and a secondary school. They are exempt organizations under Section 501(c)(3) of the Internal Revenue Code. Prior to January 1, 1978, Section 61-1-10.4(3) of the South Dakota Law excluded service performed in the employ of a school which was not an institution of higher education. Pursuant to P.L. 94-566, the "Unemployment Compensation Amendments of 1976", this exclusion was removed by the South Dakota legislature effective January 1, 1978. The two schools are therefore subject to coverage if they meet the employment requirements of 61-1-10.3(2) and are not exempted by subsections (1)(a)), (1)(b) or subsection (2) of 61-1-10.4.

Section 61-1-10.4(1)(a) exempts employees of a church or convention of churches. The employer argues the term "church" was considered by Congress, in passing the Federal Unemployment Tax Act, and by the Internal

Revenue Service to be an all-inclusive term, including integral parts of the church such as parochial schools. The term "church", however, has been interpreted to the states to be used, within the context of unemployment insurance coverage, in a limited sense and be synonymous with an individual "house of worship" maintained by a particular congregation. The employees in question are not employed by a church within this meaning Rather they are employed by the school operated by the St. Martin's Evangelical Lutheran Church or by Northwestern Lutheran Academy, a school maintained by the Synod.

The testimony establishes the schools are operated, supervised, controlled, and principally supported by a church or convention of churches. The employer argues they are also operated primarily for religious purposes and therefore exempt under 61-1-10.4(1)(b). The Referee is of the opinion that the primary purpose of the schools is education and they are not exempt under this section. The St. Martin's Evangelical Lutheran Church School is certified by the state and fulfills the legal requirement of school attendance for the students. While the courses at the church school are clearly presented from a religious orientation and viewpoint, the fact remains that the students are in school to receive an education and education, not religious purposes, is therefore the primary purpose of the school. The catalog of the Northwestern Lutheran Academy expresses the purpose of the school as a two-fold one of training future workers in the Church and of providing a general Christian education at the secondary level. Of the students at the academy, 46% go on to become teachers or pastors. The school is accredited by the state to offer a secondary level education. The courses are also taught from the Synod's

religious viewpoint. While the Academy may endeavor to recruit and train future workers in the Church, its primary purpose is not religious, but to offer these and other students a general education at the secondary level.

The pastors performing services in the church schools are exempt from coverage under Section 61-1-10.4(2) as they are a "duly ordained, commissioned, or licensed minister of the church in the exercise of his ministry." The Referee concludes the male teachers in the schools are also exempt from coverage under this section. The male teachers and pastors receive similar religious training. Their specific duties are determined by the calling body. They have equal status in the Church in many respects, including receipt of a divine, life-long call, authorization to vote on Synod matters, and ability to perform the sacerdotal functions of the Church. Pastors are called to teaching positions and teachers can and do perform pastoral duties. The position of the male teacher in the Church is equivalent to that of a pastor to such a degree as to warrant exclusion under this section. The female teachers, however, would not be exempted under 61-1-10.4(2). The phrase "ordained, commissioned or licensed" is interpreted, for unemployment insurance purposes, to mean being vested with ministerial status in accordance with the procedure followed by the particular church denomination. The female teachers do not have this status as the Scriptural position of the Synod prevents them from voting on Synod matters, which pastors and male teachers can do, and from performing the sacerdotal functions of the Church. The employer argues the female teachers are excluded because they are members of a religious order. There is, however, no established "religious order" to which they belong. Rather they perform teaching services in a

church school after receiving the required training and being "called" by the school. As the female teachers are neither ministers nor members of a religious order, they are not exempt under 61-1-10.4(2)

Finally, the employer argues that the imposition of unemployment insurance coverage on the Synod schools would be an unconstitutional entanglement between the Church and state. In view of the directive to the states from the U.S. Department of Labor mandating coverage of church-related nonprofit, elementary and secondary schools, the Referee cannot accept this argument.

DECISION

It is the Referee's decision that the St. Martin's Evangelical Lutheran Church School and Northwestern Lutheran Academy are employers subject to coverage by the South Dakota Unemployment Insurance Law. It is further held that pastors and male teachers at these schools are exempt from coverage.

Dated this 15th day of September, 1978.

/s/ Don Kattke
Don Kattke
Appeals Referee

APPENDIX D

IN THE SUPREME COURT

STATE OF NORTH DAKOTA

Grace Lutheran Church,
a corporation
(Grace Lutheran School),

Petitioner and Appellee

v.

North Dakota Employment
Security Bureau and North Dakota
Unemployment Compensation Division,

Respondents and Appellants

Civil No. 9719

Appeal from the District Court of Burleigh County, the Honorable Gerald G. Glaser, Judge.

DISTRICT COURT JUDGMENT AFFIRMED; ADMINISTRATIVE DETERMINATION REVERSED.

Opinion of the Court by Pederson, Justice.

Nilles, Hansen, Selbo, Magill & Davies, P. O. Box 2626, Fargo, for petitioner and appellee; argued by J. Gerald Nilles.

Michael J. Wilma, Special Assistant Attorney General, P. O. Box 1537, Bismarck, for respondents and appellants.

Civil No. 9719

Grace Lutheran Church

v.

North Dakota Employment Security Bureau

PEDERSON, Justice.

This is an appeal by the Unemployment Compensation Division of the North Dakota Employment Security Bureau[1] from the decision of the district court that Grace Lutheran School, a division of Grace Lutheran Church, is not subject to the provisions of the North Dakota Unemployment Compensation Law. We affirm the judgment of the district court (§28-32-21, NDCC) and reverse the determination of the North Dakota Employment Security Bureau (§28-32-19, NDCC).

This case stems from changes made in the federal and state unemployment compensation laws. Briefly, an exemption for employees of elementary and secondary schools was repealed and a directive from the Secretary of Labor was issued that the new coverage included employees of *church*-related schools. Grace Lutheran School was notified that it was subject to the unemployment compensation tax. Because this case revolves around several sections of the unemployment Compensation Laws, a brief overview of unemployment compensation legislation follows.[2]

Unemployment compensation had its beginning in the depression of the 1930's with its concurrent high levels

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[1] See Ch. 522, S.L. 1979, Job Service North Dakota.

[2] For a more detailed discussion of the history of unemployment compensation legislation see Davis, "Bringing Christian Schools Within the Scope of the Unemployment Compensation Laws: Statutory and Free Exercise Issues," 25 Villanova L.Rev. 69, No. 1 (1979-80).

of unemployment. Congress enacted the Social Security Act of 1935 to encourage states to adopt unemployment compensation statutes to alleviate some of the hardships caused by the depression. Title IX of the Act levied an unemployment wage tax on "for profit" employers with eight or more employees,[3] but allowed covered employers a credit against this federal tax liability for up to 90% of the employer's contributions to certified state unemployment funds.[4] All states enacted unemployment compensation legislation by 1937. In order to meet the requirements for federal certification, state enactments were, what has been called, "mirror images" of the federal legislation. Four years after the passage of the Social Security Act, Title IX was reenacted as the Federal Unemployment Tax Act (FUTA).

From the mid-1950's to the present, a steady expansion of unemployment compensation coverage has occurred.[5] For purposes of this case, the more significant expansion started in 1970 when the states were required to extend coverage to employees of non-profit organizations.[6] How-

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[3] Social Security Act of 1935, Pub. L. No. 271, Tit. IX, §907(a) and (c), 49 Stat. 642-43 (1935).

[4] Only payments made into *certified* state funds entitle the payor to a reduction of this FUTA liability. 26 U.S.C. §3304(a) and (c).

[5] For example, in 1954 Congress extended coverage to employers with *four* or more employees and enacted an unemployment compensation program for federal employees. See Pub. L. No. 767, 68 Stat. 1130.

[6] 26 U.S.C. §3304(a)(6). See Employment Security Amendments Act, Pub. L. No. 91-373, 84 Stat. 695. Pursuant to 26 USCA §§3301 and 3306(c) (1976), non-profit organizations are exempt from paying *federal* unemployment insurance tax even though the federal government requires the states' programs to cover such organizations.

ever, §3309(b) of FUTA continued to permit the states to exclude from coverage, services performed:

"(1) in the employ of

(A) a church or convention or association of churches, or

(B) an organization which is operated primarily for religious purposes and which is operated, supervised, controlled, or principally supported by a church or convention or association of churches;

(2) by a duly ordained, commissioned, or licensed minister of a church in the exercise of his ministry or by a member of a religious order in the exercise of duties required by such order;

(3) in the employ of a school which is not an institution of higher education."

In 1976, Congress amended §3309 by deleting subsection (b)(3), thus eliminating FUTA's general exclusion for elementary and secondary schools. In response to this amendment, the North Dakota Legislature made a number of changes to conform the state unemployment law to the federal law. Subsection (3) of §52-01-01(13)(h), NDCC, the "mirror image" of subsection (3) above, was deleted.[7] Section 52-01-01(13)(h)(1) and (2) remains unchanged and remains identical to the federal statute §3309(b)(1) and (2) quoted above.

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[7] Ch. 459, §4, S.L. 1977.

It was not until 1978 that the United States Secretary of Labor issued an opinion letter[8] officially stating for the first time that *church*-related elementary and secondary schools were covered by FUTA.[9] In response to this opinion letter, a directive was issued to all state employment agencies requiring the state agencies to assess unemployment compensation taxes against church schools.

On April 14, 1978, Grace Lutheran School, a church school owned and operated by Grace Lutheran Church, was notified that it was subject to coverage under the North Dakota Unemployment Compensation Law and that it had the option to pay the unemployment tax on a percentage basis or on a reimbursement basis. Grace Lutheran School objected on the ground that its teachers were employees of Grace Lutheran Church. Even though this is conceded by the Bureau and should have been included in findings by the Bureau, Grace Lutheran School was nevertheless required to and did elect the reimbursement method, but appealed from the determination that it was covered. A hearing was conducted before the Unemployment Compensation's Chief Appeals Referee which resulted in a determination that Grace Lutheran School was subject to the North Dakota unemployment compensation law. This decision was appealed to the North Dakota Employment Security Bu-

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[8] See *Independent Baptist Church, Etc. v. State of Tenn.*, 468 F. Supp. 71, 74 (E.D. Tenn. 1978), for a summary of the text of the Secretary of Labor's opinion letter.

[9] It is interesting to note that an administrative law judge, in a memorandum to the Secretary of Labor, noted that immediately after the 1976 amendments to FUTA were passed the Labor Department issued two non-public memoranda to the states indicating that church-school employees were still *excluded* from FUTA under §3309(b)(1). See footnote 121, 25 Villanova, L.Rev. 69 at 84.

reau which affirmed the decision of the Unemployment Compensation Division.

Thereafter, Grace Lutheran Church filed a petition for judicial review of the Bureau's decision in Burleigh County District Court. On October 11, 1979, a judgment was rendered which reversed the Bureau's decision and held that the employees of Grace Luthern School were not subject to the North Dakota Unemployment Compensation Law. The North Dakota Employment Security Bureau appealed this decision to the Supreme Court.

It is the Bureau's position that it was the intention of Congress (and the North Dakota Legislature) to cover employees of *all* elementary and secondary schools, including church-related schools, when §3309(b)(3) (and §52-01-01(13)(h)(3), NDCC) was deleted and that it is constitutionally permissible to extend unemployment compensation coverage to church-related schools.

It is Grace Lutheran Church's first contention that by deleting the subsection (3) exemption for elementary and secondary schools, public and private schools are now covered, but that employees of Grace Lutheran School are still exempt under §3309(b)(1)(A) (and §52-01-01(13)(h)(1)(a), NDCC), which provides an exemption for service performed in the employ of "a church or convention or association of churches." The trial court agreed with this contention. Secondly, Grace Lutheran Church contends that if Congress or the North Dakota Legislature intended that church schools be covered, the statute is an unconstitutional infringement on the church's First Amendment rights.

As a preliminary matter, we note that as this case involves an administrative agency, the Administrative

Agencies Practice Act (Chapter 28-32, NDCC) applies. Section 28-32-01, NDCC, defines an administrative agency to include any bureau having statewide jurisdiction and authority to make a determination which has the force and effect of law and which by statute is subject to review by the courts. The organization of the Employment Security Bureau is set out in Title 52, NDCC. Section 52-04-17 provides that the Unemployment Compensation Division may make administrative determinations with respect to whether or not an employer is covered under the unemployment compensation laws, hence it has statewide jurisdiction and authority to make determinations having the force of law. Section 52-06-27 provides for judicial review of decisions of the Employment Security Bureau.

The judicial review provisions of Chapter 28-32, NDCC, are not exclusive. Special statutes prevail if in conflict with the more general provisions of Chapter 28-32. *Evanson v. Wigen,* 221 N.W.2d 648 (N.D. 1974). However, in the instant case it appears that no such conflict exists. Both §52-06-27 and §28-32-15 provide that an appeal is to be taken within 30 days after notice of the decision of the agency. Section 28-32-19 deals with the court's scope of review on appeal. In cases where the facts are not in issue,[10] the court is to affirm the decision of the agency unless it finds:

> "1. The decision or determination is not in accordance with the law.
>
> "2. The decision is in violation of the constitutional rights of the appellant."

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[10] It could be contended that there is a conflict as to the correct standard for a court to apply in cases involving fact questions. See §52-06-27 and §28-32-19(5).

Review by the supreme court is governed by this same standard. See §28-32-21, NDCC.

Thus, the threshold questions on this appeal involve a determination of whether or not the agency's decision that church schools are covered by unemployment compensation legislation is in accordance with the law and, if so, whether or not that decision violates the constitutional rights of Grace Lutheran Church.

I. STATUTORY CONSTRUCTION

Generally, legislative intent must first be sought from the language of the statute. *Apple Creek Tp. v. City of Bismarck,* 271 N.W.2d 583 (N.D. 1978). "When the wording of a statute is clear and free of all ambiguity, the letter of it is not to be disregarded under the pretext of pursuing its spirit." Section 1-02-05, NDCC. Repeals by implication are not favored. *First American Bank & Trust Co. v. Ellwein,* 198 N.W.2d 84, 98 (1972).

In repealing the exemption for services performed "in the employ of a school which is not an institution of higher education," it is clear that public and private (non-church) elementary and secondary schools were covered by the unemployment compensation legislation. It is contended by the Bureau that *church*-operated elementary and secondary schools are covered. The issue is whether or not they are covered.

First of all, it is Grace Lutheran Church's contention that by leaving intact §3309(b)(*1*) when it repealed (b)(3), Congress intended that church-operated schools could still qualify for an exemption. Subsection (A) of §3309(b)(1) exempts all services performed in the employ of a church or an association of churches. It is

arguable that a school such as Grace Lutheran School that is not separately incorporated and whose teachers have employment contracts directly with the church would qualify for an exemption under this subsection.[11]

Secondly, Congress, in deleting §3309(b)(3) expressed no *specific* intent to require states to tax Christian schools. A recent Supreme Court decision states that in the absence of a clear expression of affirmative Congressional intent, an administrative agency may not assert jurisdiction over an organization if doing so may tend to jeopardize the religious freedoms of the organization. *NLRB v. Catholic Biship of Chicago,* 440 U.S. 490, 59 L.Ed.2d 533, 99 S.Ct. 1313 (1979). See also *Owen v. City of Independence,* — U.S. — (1980).[12]

Therefore, since Congress made no specific, express reference to church schools when deleting §3309(b)(3),

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[11] A church school whose teachers are not employed directly with the church school may still qualify for an exemption under Subsection (B) of §3309(b)(1). This section exempts services performed in the employ of an organization which is (1) operated primarily for religious purposes, and (2) operated, controlled, or principally supported by a church or convention or association of churches. As to the first requirement, the supreme court has characterized church schools as being operated primarily for religious purposes. *NLRB v. Catholic Bishop of Chicago, supra; Meek v. Pittenger,* 421 U.S. 349, 44 L.Ed.2d 217, 95 S.Ct. 1753 (1975); *Lemon v. Kurtzman,* 403 U.S. 602, 29 L.Ed.2d 745, 91 S.Ct. 2105 (1971). As to the second requirement, it would be necessary for the church school to show that it is administered by church officials, supported by church funds, that the teachers are members of the parent church, etc.

[12] In cases, where a tradition is rooted in the common law and is supported by strong policy reasons, "Congress would have specifically so provided had it meant to abolish the doctrine." *Owen v. City of Independence, supra.*

and since a persuasive argument can be made that church schools, such as Grace Lutheran, are excluded under §3309(b)(1), the required "clear expression of an affirmative intention of Congress" that church schools should pay unemployment compensation tax appears to be lacking.[13]

Applying the same rules of construction in considering the repeal of §52-01-01(13)(h)(3), NDCC, we reach the same conclusion. Without pointing out any ambiguity in the applicable statutes, the Bureau urges us to seek the intent of the Legislature from extrinsic aids. It points out that before the passage of Senate Bill 2213 [S.L. 1977, Ch. 459, §4, which repealed §52-01-01(13)(h)(3)] in a Senate committee hearing on Industry, Business and Labor, the committee members were advised that the bill would provide "protection for all state, and local governmental employees, *elementary and secondary school employees* and employees of municipalities and *parochial schools.*" [Emphasis added.] Minutes of January 24, 1977, Testimony Senate Industry, Business and Labor Committee of North Dakota Legislature.

Even though the North Dakota Legislature was informed that church schools would be covered by unemployment compensation with the repeal of §52-01-01(13)(h)(3), we conclude that the result was not accomplished. The clear and unambiguous language of §52-01-01(13)(h)(1)(a) provides an exemption for

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[13] Although several lower courts in other states have reached the same conclusion (see cases cited at footnote 116 of 25 Villanova L.Rev. 69 at 84), the South Dakota Supreme Court, in the case of *Matter of Northwestern Lutheran Academy,* 290 N.W.2d 845 (S.D. 1980), reached the contrary conclusion.

service performed in the employ of "a church or convention or association of churches." The removal of §52-01-01(13)(h)(3) did not ipso facto remove the other exemption. Furthermore, it is a long-established rule of law that if a statute is susceptible to two meanings, and one of those two meanings would make the statute invalid, the one which makes it valid prevails. See 2A Sands, Sutherland Statutory Construction (4th ed. 1972), §45.11, at 33; *State v. Julson,* 202 N.W.2d 145 (N.D. 1972); *Wallentinson v. Williams County,* 101 N.W.2d 571 (N.D. 1960); and *Marks v. City of Mandan,* 70 N.D. 434, 296 N.W. 34 (1940); all cited in *Kottsick v. Carlson,* 241 N.W.2d 842 (N.D. 1976).

II. CONSTITUTIONAL QUESTIONS

Only if we were to accept the contentions of the Bureau that church schools in North Dakota are covered by unemployment compensation as a result of the repeal of §52-01-01(13)(h)(3), could we look to see if requiring coverage violates the constitutional rights of Grace Lutheran Church. If it is possible to do so, this court avoids interpretations of statutes which place the statute in disharmony with the Constitution. *North American Coal Corp. v. Huber,* 268 N.W.2d 593 (N.D. 1978). Occasionally, however, because of public interest, we express views on issues when judicial economy indicates that issues which have been thoroughly briefed and argued should be disposed of. See, generally, *Saetz v. Heiser,* 240 N.W.2d 67, 70 (N.D. 1976). Accordingly, we will discuss the constitutional disharmony that would result from our sustaining the interpretation urged by the Bureau.

The First Amendament[14] of the United States Constitution provides: "Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof . . . ." Thus, is prohibits the government from making laws which either (1) foster the establishment of a religion or (2) prohibit the free exercise thereof. Both the establishment clause and the free exercise clause apply to the states under the Fourteenth Amendment. *Everson v. Board of Education,* 330 U.S. 1, 91 L.Ed. 711, 67 S.Ct. 504, 168 ALR 1392 (1946).

Although the scope of the establishment clause of the First Amendment is not precisely drawn, we know that it does more than forbid a state church, and that it does less than forbid every action by the government that affords a benefit to a religion. *Zorach v. Clauson,* 343 U.S. 306, 96 L.Ed. 954, 72 S.Ct. 679 (1952). In *Lemon v. Kurtzman,* 403 U.S. 602, 29 L.Ed.2d 745, 91 S.Ct. 2105 (1971), the court described the scope and main concerns of the establishment clause as follows:

> "Its author did not simply prohibit the establishment of a state church or a state religion . . . Instead they commanded that there should be 'no law *respecting* an establishment of religion.' A law may be one 'respecting' the forbidden objective while falling short of its total realization. . .
>
> "In the absence of precisely stated constitutional prohibitions, we must draw lines with reference to the three main evils against which the Establishment Clause was intended to afford protection: 'sponsorship, financial support, and active involvement of the sovereign in religious activity.' *Walz v. Tax Commission,* 397 U.S. 664, 668, 25 L.Ed.2d 697, 701, 90 S.Ct. 1409 (1970)." 403 U.S. at 612.

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[14] See also Section 4, Constitution of North Dakota.

This last aspect — concern over active governmental involvement — was further defined in *Walz supra,* as follows:

> "Determining that the legislative purpose . . . is not aimed at establishing, sponsoring, or supporting religion does not end the inquiry, however. We must also be sure that the end result — the effect — is not an excessive government entanglement with religion." 397 U.S. at 674.

To analyze whether or not a statute violates the establishment clause three tests must be applied. *Lemon v. Kurtzman, supra.*

> "First, the statute must have a secular legislative purpose; second, its principal or primary effect must be one that neither advances nor inhibits religion, *Board of Education v. Allen,* 392 U.S. 236, 243, 20 L.Ed.2d 1060, 1065, 88 S.Ct. 1923 (1968); finally, the statute must not foster 'an excessive governmental entanglement with religion.' *Walz, supra,* at 674, 25 L.Ed.2d at 704." 403 U.S. at 612-613.

If an affirmative response is possible for all three tests, the statute does not violate the clause.

The first two tests present no problem in the instant case. Extending unemployment compensation to elementary and secondary schools has a secular purpose, i.e., to avoid hardships for people temporarily without employment, and affords no basis for concluding that the legislative intent was to advance or inhibit religion. It is the last area — avoiding excessive governmental entanglement with religion — which is in issue here.

The Supreme Court has held that programs which require constant state surveillance or supervision to police them will not be tolerated. *Wolman v. Walter,* 433 U.S. 229, 97 S.Ct. 2593, 53 L.Ed.2d 714 (1977);

Tilton v. Richardson, 403 U.S. 672, 91 S.Ct. 2091, 29 L.Ed.2d 790 (1971); *Lemon v. Kurtzman, supra; Walz v. Tax Commissioner, supra; Everson v. Board of Education, supra.* In *Lemon,* a case involving grants to parochial schools for salaries of teachers of secular subjects, statutes providing for the grants were held to violate the establishment clause as fostering excessive entanglement in view, inter alia, of (1) the religious purpose and operation of church-related elementary and secondary schools, (2) the necessity of state surveillance to insure that teachers, who are subject to control by the religious organization, observed the restrictions as to purely secular education, and (3) the necessity of the state's examination of the parochial school's financial records to determine which expenditures were religious and which were secular.

These same problems appear when applying unemployment compensation legislation to Grace Lutheran Church. First of all, the church school has a religious purpose, i.e., to educate its youth in accordance with the "confessional standards" of the congregation.

Secondly, it will require extensive state surveillance to enforce the program. For example, in the directive that was issued to all state employment agencies, the states were advised that if an employee performs both non-exempt and exempt services during a single employment period, and more than one-half of the services were exempt, "then none of the services of such employee for such period shall be deemed to be employment." In other words, if employment records for any period show that an employee was engaged in religious training services more than secular training services, that employee would not be covered under the unemployment

compensation law. Thus, in the case of a teacher who is employed by a church school (non-exempt) and who also performs religious duties for the church (exempt), the state agency will have to conduct extensive audits in order to determine whether or not the employee has spent more than one-half of his time on purely religious activity. This kind of state inspection and inquiry will also require extensive records, and "entails a pervasive monitoring of these church agencies by the secular authorities." *Lemon v. Kurtzman, supra,* 403 U.S. at 627 (Douglas, J., concurring).

An equally disturbing problem arises where an employee seeks benefits, as the agency will have to determine whether or not the decision of the church school to fire or lay off the employee was justified under the "good cause" standard. The teachers employed by Grace Lutheran Church are hired partially on the basis of religious and moral qualifications and are required by contract to teach in accordance with the "confessional standards" of the Lutheran Church. Thus, disputes may arise where the church dismisses an employee for failure to teach according to the religious tenets of the church. The employee may contend that the real reason he or she was dismissed was due to budgetary concerns. In such event, the state agency would have to determine whether or not the teacher did, in fact, fail to adhere to the religious tenets of the church. This is the type of entanglement prohibited by the First Amendment to the Constitution.

These factors support the conclusion that the end result of including church schools in unemployment compensation legislation raises serious questions as to excessive governmental entanglement with religion. Accordingly,

we avoid the interpretation which creates such disharmony.

The judgment of the district court is affirmed and the determination of the North Dakota Employment Security Bureau is reversed.

APPENDIX E

U.S. DEPARTMENT OF LABOR
EMPLOYMENT AND TRAINING
ADMINISTRATION
WASHINGTON, D.C. 20213

MEMORANDUM FOR:

ALL STATE AGENCY ADMINISTRATORS AND ALL REGIONAL ADMINISTRATORS, EMPLOYMENT AND TRAINING ADMINISTRATION

FROM:

LAWRENCE E. WEATHERFORD, JR.
Administrator, Unemployment Insurance Service

SUBJECT:

Supplement #1 — Questions and Answers Supplementing *Draft Language and Commentary to Implement the Unemployment Compensation Amendments of 1976-P.L. 94-566*

Following enactment of H.kR. 10210 (P.L. 94-566) and the issuance of *Draft Lanuage and Commentary to Implement the Unemployment Compensation Amendments of 1976-P.L. 94-566,* legislative planning meetings were held in Washington, D.C., Atlanta, Georgia, Kansas City, Kansas and San Francisco, California. The enclosed questions and answers reflect inquiries made during these meetings.

The questions and answers are keyed to the applicable provision and its commentary in the *1976 Draft Legislation and are issued as a supplement to it.*

Please annotate your copies of the *1976 Draft Legislation* to reflect these additions.

Additional explanations and interpretations will be issued as needed and appropriate.

Enclosure

Supplement 1, 1976 Draft Legislation
December 7, 1976

* * *

Service excluded from required coverage of nonprofit organizations, section 2(k)(1)(D)
Refer: Commentary, page 25

1. *Question:*

   Do the 1976 amendments affect church related schools?

   Answer:

   Yes, to the extent that coverage is extended to elementary and secondary schools. In other respects no changes were made, and the exclusion in sections 3309 (b)(1), (2), (4), and (5) are still applicable. Accordingly the commentary on pages 27-30, *1970 Draft Legislation,* together with subsequent interpretations and explanations are still applicable.

   For example, the coverage of nonprofit elementary and secondary schools does not affect the optional exclusion in 3309(b)(1). The factors significant in determining whether or not service is performed

   > "(1) in the employe of (A) a church or convention or association of churches, or (B) an organization which is operated primarily for religious purposes and which is operated, supervised, controlled, or principally supported by a church or convention or association of churches"

remain unchanged.

Some of these matters were dealt with in various issues of Interpretation Series, P.L. 91-373 which are still pertinent.

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APPENDIX F

U.S. DEPARTMENT OF LABOR
EMPLOYMENT AND TRAINING
ADMINISTRATION
WASHINGTON, D.C. 20213

MEMORANDUM FOR:

ALL STATE AGENCY ADMINISTRATORS AND ALL REGIONAL ADMINISTRATORS, EMPLOYMENT AND TRAINING ADMINISTRATION

FROM:

LAWRENCE E. WEATHERFORD, JR.
Administrator, Unemployment Insurance Service

SUBJECT:

Supplement #2 — Questions and Answers Supplementing *Draft Lanuage and Commentary to Implement the Unemployment Compensation Amendments of 1976—P.L. 94-566*

By this time a number of draft proposals to implement the provisions of P.L. 94-566 have been sent to the National office for review. The enclosed questions and answers reflect issues that have arisen in the course of that review.

The questions and answers are keyed to the applicable provision and its commentary in the *1976 Draft Legislation* and are issued as the second supplement to it.

Please annotate your copies of the *1976 Draft Legislation* to reflect these additions.
Additional explanations and interpretations will be issued as needed and appropriate.

Enclosure

Supplement 2, 1976 Draft Legislation
February 2, 1977

* * *

Definitions — service for nonprofit organizations, section 2(k)(1)(C)
Refer: Commentary, page 25

1. *Question:*

Must an "organization" be a "legal entity" for the purposes of section 3309(b)(1), FUTA?

Answer:

No. Section 3309(b)(1) provides that service performed —

> "(1) in the employ of (A) a church or convention or association of churches, or (B) an organization which is operated primarily for religious purposes and which is operated, supervised, controlled, or principally supported by a church or convention or association of churches"

may be excluded from the required coverage of governmental entities and nonprofit organizations.

The word "organization" is broader than the phrase "legal entity" and will include but not be limited to such entities. Accordingly, an organization within the meaning of section 3309(b)(1) need not be a separate legal entity, but includes any organization other than the unit constituting a church or convention or association of churches, even though the organization may be so closely connected to the church, etc., as in fact to be operated, supervised or controlled by the church itself. See also the Answer to Question 2 below.

Definitions — service for nonprofit organization, section 2(k)(1)(C), cont.
Refer: Commentary, page 25

2. *Question:*

What factors govern the application of the exclusions in section 3309(b)(1)(A) and (B), FUTA?

Answer:

Only services performed directly in the employ of a church or convention or association of churches, as distinguished from any other organization, are excluded under subparagraph (A). The exclusion in (B) involves a two part test: (1) Is the employer some other organization than the church or a convention or association of churches? (2) Are the services performed for an organization which is (operated, supervised, controlled, or principally supported by a church, or convention or association of churches) operated primarily for religious purposes?

The fact that the organization is owned, operated, supervised and controlled by a church does not justify a conclusion that the services performed for the organization are performed in the employ of the church rather than the organization. Ownership does not necessarily signify exclusive possession and control. Ownership may be retained concurrently with the creation and exercise of other legal interests. Furthermore, the form under which the organization is operated, supervised or controlled may be distinct from that entity which operates, supervises and controls the religious activities of the church, even though the church retains ownership of the organization and even if the same individuals comprise the authority of both the organization and the church.

With respect to the second test, if the services are performed for an organization other than the church, the

services may be excluded *only* if the organization (which is operated, supervised, controlled or principally supported by a church or convention or association of churches) is operated primarily for religious purposes.

Supplement 2, 1976 Draft Legislation
February 2, 1977

Definitions — service for nonprofit organization, section 2(k)(1)(C), cont.
Refer: Commentary, page 25

Thus, under section 3309(b)(1), FUTA, it must first be determined whether the workers in question are employed by a church or by an organization other than the church. If the workers are employed by a church, their services are excluded. Whether the church is the employer is primarily a question of fact. If, however, the workers are not employed by the church, it must then be determined whether the employing organization is operated primarily for religious purposes. If operated primarily for religious purposes, the services are excluded only if the employing organization is operated, supervised, controlled or principally supported by the church.

The determination of whether the exclusion applies can be made only after a thorough analysis of the legal interests and relationships between the organization and the church.

The changes made in section 3309 by P.L. 94-566 do not change the application of the exclusions in section 3309 (b)(1)(A) and (B).

* * *